European Commission proposes Anti-Tax Avoidance Package

5 February 2015

In brief

On 28 January 2016, the EU Commission (EC) presented its Anti-Tax Avoidance Package (ATAP), which consists of seven parts:

- legislative proposals for an Anti-Tax Avoidance Directive (draft ATA Directive)
- legislative proposals for an amendment to Directive 2011/16/EU to coordinate implementation of G20/OECD BEPS country-by-country reporting (CBCR) requirements
- a proposed ‘EC Recommendation’ to Member States on the implementation of G20/OECD BEPS recommendations on tax treaty abuse and on permanent establishments (PEs)
- a general policy ‘Communication’ on the ATAP and the proposed way forward
- a general policy ‘Communication’ on an EU external strategy for effective taxation
- an EC Staff Working Document and
- a Study on Aggressive Tax Planning.

Building on our EUDTG Newsalert of 28 January, which explained the different parts of the ATAP, this bulletin provides more context, analysis and insight into the work done in this area by the EC, the resulting proposals and their impact.

In summary, the continuing political will to address elements of tax avoidance may well result in the 100% consensus required by EU Member States to effect at least some of the proposed tax changes. The EU-28 governments will have to decide if they are willing to go further than was agreed by the 21 of them that participated in the G20/OECD BEPS outcomes on interest limitation rules, hybrid mismatches, controlled foreign companies (CFCs), tax treaty abuse and PEs. Reaching agreement on additional areas addressed in this package may be more difficult. These areas include legislative proposals on harmonized exit taxation, general anti-avoidance rules (GAARs) and switch-over clauses, effectively providing for a minimum level of taxation with tax credit relief rather than exemption. There are potential concerns over whether there are matters that should be considered at an individual Member State level rather than an EU level (subsidiarity), or that breach the ‘fundamental freedoms’ written into the EU Treaties. Member States and other stakeholders likely will debate elements of the strategy for increased tax transparency (including public CBCR), fairer tax competition, State aid and good governance criteria including action against ‘listed’ countries that don’t adhere to these criteria.
In detail

Background to the package and the ‘chapeau’ Communication

There is perhaps as great a focus now on companies paying taxes in the countries where economic activity takes place and profits are generated as there was when the G20/OECD BEPS Project began.

In its ‘chapeau’ or overview Communication, the EC reiterates that, for the EU ‘Single Market’ concept, it is imperative that there is a “fair, efficient and growth-friendly corporate tax system” based on this principle. The EC previously said this in its June 2015 Action Plan for a Fair and Efficient Corporate Tax System in the EU. It points to the Common Consolidated Corporate Tax Base (CCCTB) as the ultimate goal in this regard, stating that it is on track to adopt new legislative proposals in Autumn 2016 (elsewhere mentioned as the final quarter of 2016). But that is likely to be a two-stage process. The first part would be a more immediate need and opportunity to address specific avoidance issues; the second would be the remainder of the CCCTB.

The Communication notes that aggressive tax planning (ATP) distorts price signals and allows exponents to enjoy lower capital costs, disrupting the level playing field in the Single Market. It notes that small and medium-sized enterprises (SMEs) are particularly affected by this phenomenon. ATP requires less mobile taxpayers to carry a heavier burden, according to the policy communications, “eroding fairness, reducing general tax-payer morale and threatening the social contract between citizens and their governments”. One additional driver for addressing avoidance is quoted as the significant revenue losses suffered by Member States.

The EC stresses the need for coordinated action across the EU. It recognizes the need to bring certainty and reduce administrative burdens for taxpayers. But it also points out that uncoordinated action could:

- create loopholes for aggressive tax planners and undermine effectiveness of rules in other Member States and
- encourage suboptimal responses by Member States intensifying efforts to attract multinationals.

The Communication mentions, as influences on the ATAP:

- the G20/OECD BEPS recommendations agreed in the last quarter of 2015. The EU can go further to coordinate via new EU legislation/ Directive on interest limitation rules, hybrid mismatches and CFCs and amending existing legislation/ Directive on CBCR. However, it cannot impact tax treaties signed by Member States, so it can only issue a Recommendation on tax treaty abuse and PEs
- the CCCTB discussions, going back as far as the original 2011 proposals, adding further legislative proposals on exit taxation, general anti-avoidance rules (GAARs) and clauses to switch over from the provision of a tax exemption to a tax credit in specific circumstances
- other aspects of the EC’s Action Plan for a Fair and Efficient Corporate Taxation System in the EU, the EU Parliamentary reports of the ECON and TAXE I Committees, the Addis Ababa Action Agenda and 2030 Agenda for Sustainable Development for a more coordinated EU approach to third countries on tax matters - better promoting international tax good governance standards globally and further supporting third countries in meeting these standards (including a new EU process for assessing and listing countries not meeting them with appropriate counteraction).

Apart from these actions, the background papers also mention ‘soft’ law which can be delivered through EU advisory groups: the Joint Transfer Pricing Forum, the Code of Conduct Group for Business Taxation and the Platform for Tax Good Governance.

Observations: Insofar as the EC states that measures included in ATAP are designed to minimise risk of double taxation and disputes ‘as much as possible’, this may have been in their minds but some taxpayers will consider that there are significant risk areas associated with the proposals.

The ATA Directive

Overview and impact

The proposed Directive would apply to all taxpayers (including PEs) that are subject to corporate tax in Member States (per proposed Article 1). It targets tax avoidance practices that the EC believes directly affect the functioning of the internal market.

The proposed Directive includes minimum standards to be enacted irrespective of whether the situation involves cross-border transactions. It would not prevent Member States from having other anti-avoidance rules designed to give greater protection to corporate tax bases, whether in domestic legislation or by agreement with other countries (per proposed Article 3).

Observations: Despite the EC stating that the ATA Directive is based on the G20/OECD BEPS recommendations, in some important areas the EC’s draft proposal’s rules differ from the corresponding BEPS items. Significantly, there is no Impact Assessment related to these proposals, although the EC obliquely refers to other work done related to BEPS, CCCTB, etc.
**Fiscal sovereignty and subsidiarity**

EU Member States have retained their fiscal sovereignty in the field of direct taxation. This extends to both the design of measures to determine taxing rights under national law, and to the allocation of taxing powers through tax treaties.

However, although the ability to determine and allocate taxing rights falls within the exclusive competence of Member States, those taxing rights must be exercised in compliance with EU law, including the ‘fundamental freedoms’ enshrined in the TFEU, EU Directives, and EU State Aid rules.

Under the principle of subsidiarity, action is not taken at an EU level unless it is more effective than action taken at a national level.

The explanatory memorandum to the ATA Directive states that the Directive’s proposals comply with the principle of subsidiarity as the objectives of tackling cross-border tax avoidance and co-ordination of implementing BEPS recommendations cannot be achieved by Member States acting alone.

In this regard, notably, the OECD in its BEPS work recognised in many areas that countries needed flexibility to implement their recommendations in a manner consistent with the policy objectives of their overall tax systems (see, for example, the work on CFC rules).

In addition, it will be necessary to consider proportionality and that these proposals are not more restrictive than is necessary to achieve their aims.

**Legality and treaty freedoms**

The TFEU fundamental freedoms of most direct relevance in the context of the ATA Directive are the freedom of establishment within the EU, and the free movement of capital, which applies to movements of capital both between EU Member States and between EU Member States and third countries.

**Interaction with treaties with non-EU countries**

The interactions of these proposals with obligations established under double tax treaties with non-EU countries will need to be considered carefully.

**Interest limitation rules**

The stated aim of the proposals in proposed Article 4 on limiting interest deductibility is to discourage MNEs from reducing the tax base through inflated group financing. However, it is not limited to net interest but to wider ‘excess borrowing costs’ (with a number of terms defined in proposed Article 2). The cost side also involves other equivalent costs that a taxpayer incurs in connection with the borrowing of funds, including:

- any difference between the borrowed funds and the maturity amount (premium)
- the interest element in a leasing contract where the economic owner is entitled to deduct such interest and
- expenses incurred in connection with raising finance.

The revenue side of the equation involves interest and equivalent revenues from ‘financial assets’ (as defined).

Subject to a group carve-out rule, any excess borrowing cost is deductible up to 30% of EBITDA to a maximum of EUR 1m. The group rule broadly allows full deduction if the proportion of equity to total assets of the taxpayer is at least 98% of that of the group as per appropriately audited consolidated accounts. Taxpayers would have to ignore contributions to equity/total assets in the six months prior to the balance sheet date insofar as they are matched by withdrawals/distributions in the six months following it.

The proposals include an unlimited carryforward for unutilized EBITDA and non-deductible borrowing costs.

The exclusion currently set out for financial undertakings is temporary. The EC suggests the intention is to propose specific rules by November 2016 when discussions, at the OECD and elsewhere, about the specific nature of the issues involving banks, etc., are more developed.

**Observations:** Note that there is no distinction as to where debt originates. The EU has opted to allow the carryforwards permitted by the G20/OECD report on BEPS project Action 4 and to choose a percentage of EBITDA within the permitted corridor of limitations (at the upper end). But there are differences between these proposals and those recommended in that report. The fact that the group option is not the same as the proposed group option under the G20/OECD BEPS Action 4 recommendations will probably give rise to debate. There are also a number of potential interpretations that might create uncertainty, including:

- Assets and liabilities should be valued using the same method as the consolidated financial statements. Does being ‘included in audited consolidated financial statements’ sufficiently determine the accounts and balance sheet date for inclusion in the group rule if the taxpayer’s accounts are not coterminous with the consolidated accounts?
- While unrelieved borrowing costs can be carried forward up to a limit of 30% of EBITDA ‘in the same way as the borrowing costs for those years’, is the intent for one restriction the following year for the aggregate of the current and brought-forward amounts or
is each year’s amount subject to a separate 30% limit?
• Insofar as there is a proviso for application of the group rule that ‘payments to associated enterprises do not exceed 10% of the group’s total net interest expense’, should this really apply to ‘net borrowing costs’?

There are a number of interactions with EU law that will require consideration, including whether the measures satisfy the proportionality test. Note that in the Thin Cap GLO case (Test Claimants in the Thin Cap Group Litigation C-524/04) concerning the application of freedom of establishment to cross-border thin capitalisation rules, the CJEU ruled that in order for such limitation rules to be proportionate, taxpayers must have the opportunity to provide commercial justification for excess interest expense.

Exit taxation rules

The Article 5 proposals aim to prevent tax base erosion with tax jurisdiction transfers without any ownership change (with a number of defined terms in proposed Article 2). There would be an exemption where the transfer is temporary with the intention to revert to the transferor state. As noted, there is no equivalent provision in the G20/ OECD BEPS report.

The market value (arm’s length) of the assets involved in the transfer minus their tax value (written down or otherwise) is to be taxed where a taxpayer:
• transfers assets (between a head office and its PE, or between PEs) out of a Member State’ or
• transfers its tax residence out of a Member State or
• transfers its PE out of a Member State.

In line with CJEU case law, the tax could be deferred and paid in instalments over a period of at least five years (with interest and/or guarantee in accordance with rules in the Member State) if the transfer is within the EU/EEA. The basis of the asset would then equal that same market value in the transferee state.

The outstanding tax debt becomes immediately recoverable if:
• the transferred assets are disposed of
• the transferred assets are subsequently transferred to a non-EU country
• the taxpayer’s tax residence or its PE is subsequently transferred to a non-EU country
• the taxpayer goes bankrupt or is wound up.

Observations: While many Member States already have exit rules, the nature of the current proposals would probably need changes to existing legislation (e.g., the UK, Germany, the Netherlands, Italy, Belgium and Spain).

The proposal specifics include the option to defer tax payment to ensure compliance with CJEU case law, which has held that the immediate taxation of unrealised gains on migration (National Grid Indus BV C-371/10) or on the transfer of assets between EU Member States within the same legal entity (Commission v Portugal C-38/10, Commission v Spain C-64/11, Commission v Denmark C-261/11) is contrary to the freedom of establishment.

There is no definition of the period for which a transfer is regarded as ‘temporary’ for purposes of the exemption. There is also a question as to the continued deferral where an asset is transferred or the taxpayer’s tax residence (or its PE) is transferred to an EEA country, since the recapture situations refer to any non-EU country.

Switch-over clause

The aim of proposed Article 6 is to ensure taxation of income in respect of businesses in a low tax non-EU country, i.e., ensuring a minimum level of tax on revenues derived from that income. As noted, there is no equivalent provision in the G20/ OECD BEPS report. A number of Member States have branch profit and dividend/capital gains participation exemptions but while some, like Germany, the Netherlands, Italy and Spain have switch-over clauses that apply in certain instances, others like the UK and Belgium do not.

Member States would not be able to exempt a taxpayer from tax on:
• profits distributions from an entity in a non-EU country
• proceeds from the disposal of shares held in an entity in a non-EU country or
• income from a PE in a non-EU country,

where the entity/PE is subject to a statutory corporation tax rate which is less than 40% of the statutory rate applicable in the taxpayer’s Member State. Instead, these amounts must be subject to tax with credit.

This is not designed to apply to losses.

Observations: The Luxembourg EU Council Presidency's tax working party summary of 2 December 2015 indicated that discussions among Member States stated that the switch-over clause would only apply where both the low-tax test was met and there was no agreement for automatic exchange of information (AEOI).

However, the draft Directive does not include the requirement regarding the AEOI. If adopted as drafted, this might deny participation exemptions in a wide range of circumstances, contrary to tax policy trends in both
the EU and globally. The explanatory memorandum to the draft Directive indicates that the switch-over clause complies with EU law since it results in third country income flowing into the EU being taxed at the same level as domestic income. Thus, the interaction of the switch-over clause and EU law may perhaps be more complicated than this and may therefore warrant further analysis.

General anti-abuse rule (GAAR)

The aim of proposed Article 7 is to tackle abusive tax practices not yet dealt with through other specific provisions. As noted, there is no equivalent provision in the G20/OECD BEPS report.

The proposal is effectively a direction for tax authorities to apply a standard EU-wide GAAR to ignore arrangements where the essential purpose is to obtain a tax advantage that defeats the object or purpose of the tax provision and where the arrangements are regarded as non-genuine.

The tax liability would then be calculated by reference to economic substance in accordance with national law.

Within the EU, this would be limited to ‘wholly artificial arrangements’ to ensure compliance with the EU fundamental freedoms and case law (see Legality and Treaty Freedoms above).

Observation: Considering the very detailed GAARs in some countries and the experience many tax authorities have had in trying to use them effectively, the short principles-based wording here without the body of guidance, which typically goes with many domestic versions, seems to create risks of significant uncertainty for taxpayers. A brief PwC survey confirmed a degree of uncertainty as to whether the existing GAARs of some Member States would require changes. Note that EU case law (including SIAT C-318/10) has established that anti-avoidance provisions need to be well defined in order to meet the requirement of legal certainty.

Controlled Foreign Company (CFC) rules

Approximately half of the 28 Member States currently have CFC rules. So it may be difficult to reach a consensus which requires close to half the Member States to adopt CFC rules and some of the others to change their existing regimes. In the discussions resulting in the Action 3 recommendations in the G20/OECD BEPS report, it appears similar problems were identified and it was only possible to provide some broad-ranging building blocks for the countries that wanted to incorporate a CFC regime.

Proposed Articles 8 and 9 aim to eradicate the incentive of shifting income. This would be achieved by re-attributing non-distributed income of a low-taxed CFC, which is not a publicly listed company, to its parent company.

Three principal criteria must be assessed before re-attribution would be required:

- the parent’s interest in the entity, involving consideration of whether it (or with associated enterprises) has broadly more than 50% of the voting power, capital or entitlement to profits
- the entity being subject to a low level of taxation (40% of the parent’s effective rate) and
- more than 50% of the entity’s income falling within specified categories (broadly, passive income).

Note that the low level of taxation is now framed against the parent’s effective tax rate, rather than the average tax rate of Member States as in the CCCTB proposal. This will give rise to different results based on the parent’s jurisdiction.

Where the CFC is resident in the EU/EEA, the rules only apply if the entity’s establishment is wholly artificial or the entity engages in ‘non-genuine arrangements’ (as defined) with the essential purpose of obtaining a tax advantage. This condition is to ensure compliance with the EU fundamental freedoms and case law, as determined in Cadbury Schweppes (C-196/04). This case concerned the compatibility of the UK CFC regime with the freedom of establishment. The CJEU held that although the rules restricted the freedom of establishment, this could be justified based on prevention of tax avoidance provided the rules only applied to “wholly artificial arrangements intended to escape the national tax normally payable”. The CJEU went on to state that CFC rules “…must not be applied where it is proven on the basis of objective factors... that, despite the existence of tax motives, that controlled company is actually established in the host Member State and carries on genuine economic activities there”.

As regards application to non-EU countries, it may still be necessary to consider whether the freedom of movement of capital is relevant (as this can apply in transactions with non-EU countries), and if so whether the provisions are consistent with the freedom. In addition, the provisions will also need to satisfy the proportionality test.

This article would also exclude EU/EEA financial undertakings.

The computation of the re-attributed income would be carried out in accordance with rules in proposed Article 9. Essentially this means using the tax rules of the parent’s Member...
State. The taxpayer applies them in proportion to its entitlement to receive profits with appropriate offset of distributed amounts against such income. Any undistributed amounts would then offset any gain on entity disposal.

There is not necessarily alignment with the G20/OECD BEPS Action 3 building blocks, mentioned above, because of the level of flexibility in those recommendations. The EC proposals would apply both a legal and an economic control test so that satisfaction of either test results in control at a 50% level, directly or indirectly. They also include an exemption where the tax rate is high enough, and a definition of attributable income that uses parent company Member State rules, limits the offset of losses and, arguably, seeks to address BEPS concerns. The double taxation safeguards are less clear given that the OECD recommended a credit for foreign taxes actually paid, including CFC tax assessed on intermediate companies. This was absent from the EU proposals, unless it is intended to be included in use of the parent company Member State rules.

**Observations:** It is not clear that even those Member States with existing CFC rules would necessarily comply with the proposal as currently drafted. Also those States may be reluctant to amend their existing rules (e.g., the UK, Germany, Netherlands, Italy and Spain). Also, as noted above, the CFC provisions may prove controversial for many other Member States. In particular, Member States may raise subsidiarity concerns about whether these are within the EU’s scope to determine. As the OECD noted in the BEPS Action 3 report “because each country prioritises policy objectives differently, the recommendations provide flexibility to implement CFC rules that combat BEPS in a manner consistent with the policy objectives of the overall tax system and the international legal obligations of the country concerned”. There is some analysis included in that report about EU legality and CJEU case law, but it may warrant a more thorough review.

**Hybrid mismatch rules**

Proposed Article 10 aims to prevent outcomes where there is a double deduction or deduction with no income inclusion. It seeks to address mismatches between Member States’ tax systems arising due to the use of hybrid entities or hybrid instruments. Hybrid mismatches between Member States and non-EU countries will be further examined.

Under the proposed treatment in the ATA Directive, characterization of the entity or instrument in the Member State where the payment has its source would be followed by the other Member State involved in the mismatch.

**Observation:** This proposal would result in treatment contrary to the G20/OECD BEPS Action 2 recommendations. For example, in relation to hybrid instruments, those recommendations would, as a primary rule, require the payer jurisdiction to deny a deduction for mismatch payments, whereas the EU proposal would require the payee to include such payments as income. The different approach might be driven in part by CJEU case law which has indicated that the fact that payments are taken into account in another Member State cannot justify discriminatory treatment in the source Member State (see, inter alia, Philips Electronics C-18/11).

The EU’s source-based approach might be seen as having the merits of simplicity and is consistent with the anti-abuse provisions set out in the amended Parent-Subsidiary Directive (2011/96/EU). However, some jurisdictions may well use the OECD rules and the EU’s proposal may be regarded as over-simplistic. Non-uniform adoption of the hybrid rules globally may potentially result in more double taxation and controversy. This could impact investment decisions. Companies and other investors outside the EU may hesitate to locate profitable operations or make other substantial funding commitments in jurisdictions that apply these concepts in a manner likely to result in double taxation.

**Directive on mandatory automatic exchange of information for CBCR**

An amending Directive is being proposed to update Directive 2011/16/EU on administrative cooperation in the field of taxation. This update will allow for mandatory AEOI in the field of taxation, in particular in relation to CBCR. This is popularly known as DAC4, as the fourth iteration of the so-called Directive on Administrative Cooperation.

The aim is that MNE groups with revenues of at least EUR 750m (or equivalent in national currency as of January 2015) should provide various information annually to the tax authority of their residence and that the tax authority will then share that with other affected Member States. The information will broadly include, for each tax jurisdiction in which the MNE does business, on the form specified in new Annex III to be included in DAC4 (being added by the Annex to the amending Directive):

- revenue
- profit before income tax
- income tax paid and accrued
- number of employees
- Stated capital
- retained earnings
- tangibles assets (other than cash or cash equivalents) and
• identification of each constituent entity, its tax residence (and if different where organised), and its main business activities.

We understand that the amending Directive could enter into effect on 1 January, or perhaps more likely on 1 July 2017 and would require this reporting process for fiscal years beginning from 1 January 2016. MNE’s will have 12 months from the end of the reporting period in which to file the report. The tax authority has 15 months from the end of the reporting period to share the MNE’s report with other affected Member States.

Annex III mentioned above also provides for the secondary mechanism whereby a ‘Constituent Entity’ resident in a Member State which is not the ‘Ultimate Parent Entity’ of an MNE Group will have to file a CBCR in its residence state if one of the following conditions applies:

• the Ultimate Parent Entity of the MNE Group is not obliged to file a CBCR in its jurisdiction of tax residence or
• the jurisdiction in which the Ultimate Parent Entity is resident for tax purposes has signed a current requirement to share (an International Agreement) to which the Member State is a party but does not have the capacity (an appropriate competent authority agreement) by the time specified for filing the CBCR
• despite having capacity to share (an appropriate competent authority agreement) there has been a systemic failure of the non-EU jurisdiction of tax residence of the Ultimate Parent Entity to use it properly and its Member State of residence has notified the Constituent Entity of this fact.

Observations: The proposed amendment is a relatively straightforward implementation in a standardised manner across EU Member States of the OECD/G20 BEPS Action 13 rules on CBCR to tax authorities. This amending Directive could be adopted in Council within a few months, if as expected the Member States raise no new technical issues. The EC nevertheless intends to issue a proposal and Impact Assessment for public CBCR, as previously announced, in Spring 2016 (March has previously been mentioned).

EC Recommendation on treaty abuse and PE status

The EC has proposed a short and simple Recommendation covering two aspects of the OECD/G20 BEPS outcomes:

• treaty abuse (Action 6) and
• PE status (Action 7).

Since the EC cannot impose legislative requirements on Member States in relation to treaty agreements, (see Fiscal Sovereignty and Subsidiarity above), it must rely on political pressure alone. Member States would have to inform the EC of the measures taken in order to comply with the Recommendation, as well as on any changes made to such measures. The Commission would then publish a report on the application of this Recommendation within three years of its adoption, on the implementation by Member States.

Instead of the options involving a limitation of benefits (LoB) clause (the OECD final report on BEPS Action 6 noted that an LoB could give rise to EU law concerns, which would need to be addressed and which were also reflected in the EC infringement action against the Netherlands in relation to its double tax treaty with Japan), the EC recommends Member States adopt what it calls “a general anti-abuse rule based on a ‘principal purpose test’ (PPT) of transactions or arrangements” in the following form:

“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.”

The exclusion of arrangements reflecting genuine commercial activity is presumably intended to ensure compliance with EU law.

The preamble to the recommendation on PE status refers to difficulties with business models of the digital economy. It also mentions that the targets are particular commissioner arrangements and the exploitation of the specific exceptions for preparatory and auxiliary activities. The recommendation is then as follows:

“Member States are encouraged, in tax treaties which they conclude among themselves or with third countries, to implement and make use of the proposed new provisions to Article 5 of the OECD Model Tax Convention in order to address artificial avoidance of permanent establishment status as drawn up in the final report on Action 7 of the Action Plan to address Base Erosion and Profit Shifting (BEPS).”

Observation: Both recommendations adopt the more EU typical principle-based approach with regard to the level of detail set out.
They are brief and to the point, but this may lead to a lack of clarity in their interpretation. The need for anti-avoidance legislation to clearly target abusive arrangements is reflected in the limitations of recommendations for proposals on treaty abuse to wholly artificial situations.

**Study on Structures of Aggressive Tax Planning and Indicators**

The EC commissioned a report on ATP from two Danish-based organisations, Ramboll Management Consulting and Corit Advisory. The resulting 176-page report was produced with the support of a network of independent national tax experts (listed on p152 of the report).

The study was commissioned to:

- identify model ATP structures
- identify ATP indicators that facilitate or allow ATP
- review the corporate income tax systems of the EU Member States by means of the ATP indicators, in order to identify those tax rules and practices (or lack thereof) that result in the vulnerability of Member States to ATP.

The study screens each Member State tax system for provisions relevant to four well-known corporate tax structures identified by the OECD, and an additional three model ATP structures suggested by the writers. The seven model structures are:

- a hybrid financing structure
- a two-tiered IP structure with a cost-contribution arrangement
- a one-tiered IP with a cost-contribution arrangement
- an offshore loan structure
- a hybrid entity structure
- an interest-free-loan structure and
- a patent-box ATP structure.

The writers drew out 33 ATP indicators – generic characteristics of a tax system that have the potential to facilitate ATP. They split these into three categories:

- **active indicators** which directly promote or prompt an ATP structure
- **passive indicators** which are necessary in order not to hinder or block an ATP structure and
- **lack of anti-abuse ATP indicators** which represent the lack of rules aimed at counteracting tax avoidance.

The study involved questionnaires completed by the national tax experts in May and June 2015. Member States were provided an opportunity for additional input based on the results.

The key findings set out in the study's report (Taxation paper No. 61) were:

- active indicators were found in 15 Member States, and three Member States had three active indicators
- passive indicators were found in all Member States and most Member States exhibit between three to five passive indicators and
- all Member States except two have indicators showing a lack of anti-abuse rules.

The conclusions drawn by the writers included:

- financing costs – 28 Member States have indicators and 24 have at least two indicators
- dividends – 13 Member States have a combined set of indicators, so rules to counter ATP based on the tax-free flow-through of dividends are already well established (but 13 did not apply any beneficial-owner test when accepting a claim for a reduction or exemption of withholding tax)
- CFC – 14 Member States do not have CFC rules
- very few Member States have rules to counter the mismatching tax qualification of a local partnership or company by another state (typically the state of the owners)
- 26 Member States have general or specific anti-avoidance rules that may address parts of the model ATP structures but, based on the information collected, they only partially dealt with the issues.

The report includes a full list of indicators for each Member State. The writers suggested this could comprise a basis for joint work between Member States to prevent ATP.

The authors noted one important omission: Overseas Countries and Territories (OCT) and Outermost Regions (OMR) may have their own tax systems and are only discussed in outline. These territories and regions are listed in various articles of the TFEU.

**Observations:** While this study was commissioned by the EC, it does not necessarily reflect EC views. However, it has been published as part of the package and it is referenced in the other papers, so the EC presumably considers it credible, in part perhaps because Member States were given the opportunity to comment before its publication, though perhaps only limited review was possible in the time available.

**EC Staff Working Paper**

The EC's Staff Working Paper reiterates the estimates of a recent study commissioned by the European Parliamentary Research Service that the revenue loss from profit shifting solely within the EU was EUR 50-70 billion, equivalent to 17-23% of 2013 corporate income tax revenue.

The document suggests ATAP should be considered alongside:

- work carried out by the Expert Group on Taxation of the Digital Economy
- initiatives to reform and modernise the EU VAT system,
paying particular attention to the interaction with the Digital Single Market and
• investigations into the tax ruling practices of Member States under State aid rules since 2013 (and the adoption of three decisions in October 2015 and January 2016).

The EC’s staff paper also stresses that the proposals cover elements that have already been discussed extensively. ATAP merely presents a pragmatic approach bringing together various initiatives. The prior ‘consultation process’ is described as including:

• work done on the OECD/G20 BEPS project outcomes
• discussions on the international aspects of the CCCTB (including 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 summary of BEPS project recommendations or best practices and underlying analyses have been well documented elsewhere. The overview of the Study on Structures of Aggressive Tax Planning and Indicators is no more than that.

The EC staff paper does effectively conclude with what objectives and features were paramount in their minds when drafting ATAP ‘in line with Member States’ commitments’.

• The objective of ATAP is, they state, to enhance the smooth functioning of the Single Market and thereby support the ability of the Single Market to secure sustainable growth, employment and competitiveness - a fair, efficient and growth-friendly corporate taxation is a key element of a strong Single Market.
• If there is one weaker link within the EU, in their view it is that MNEs that seek to avoid taxes could exploit it. Accordingly, they believe this calls for putting forward rules that would set a common minimum level of protection against tax avoidance in the Single Market.

• The proposed rules are also intended to ensure that the BEPS outcomes are implemented in full compliance with EU law, including the fundamental freedoms as well as fundamental rights as enshrined in the EU Charter of Fundamental Rights.

Observations: The EC’s staff working document unsurprisingly duplicates much of the information set out in the rest of the package. There is little additional information or insight, although it tries to tie in the various different forums, requests, actions and justifications for ATAP. As noted above, the claim that they framed implementation of BEPS measures in accordance with EU law may require further consideration in certain areas.

Communication – external strategy for effective taxation

The Communication sets out the EC’s ideas for promoting tax good governance with non-EU countries, as tax avoidance is considered to be a global problem. The external strategy outlines a response to external challenges to their tax bases, to complement the internal EU measures against tax avoidance. A more coherent EU approach to working with international partners for a high level of tax good governance globally is also needed in the EC’s view. The External Strategy also seeks to create a better link between the EU’s tax policy priorities and its wider external relations. This includes using EU tax policy to greater effect in order to support other important policy commitments, such as international development.

The five main elements of the External Strategy are:

1) Updated good tax governance criteria

The updated criteria refer to the new standards on tax transparency and exchange of information, fair tax competition, the OECD BEPS standards and the Financial Action Tax Force (on money laundering: FATF) standards on Combating Money Laundering and the Financing of Terrorism. With regard to fair tax competition the Strategy references the criteria of the Code of Conduct on Business Taxation and the outcome of the framework that the OECD/G20 will create to monitor the BEPS implementation. These criteria should be applied by Member States in their relations with third countries, should underpin all EU external policies on tax matters, and should be used to assess whether or not countries comply with global standards. The criteria serve as a basis for the commitments the EU will seek in agreements with third countries (second element of the external strategy) and when screening third countries (fifth element of the external strategy).

2) Tax clauses in (trade) agreements with third countries

The EU has the ambition to use agreements with third countries to promote fair and transparent corporate taxation and wants to negotiate tax good governance clauses in trade, association and partnership agreements.

3) Assistance to developing countries on tax matters

Through the Addis Tax Initiative the EC has committed to doubling the support to developing countries for domestic resource mobilization (DRM). DRM is considered crucial for inclusive growth, poverty eradication and sustainable development. Assisting developing countries to implement the BEPS agenda is
intended to help them to fight off threats to their tax base, and also will prevent weaknesses in the international tax structure that may create opportunities for base erosion and profit shifting.

4) **Tax good governance criteria for EU funds**
The EU Financial Regulation prohibits EU funds from being invested in or channeled through entities in third countries that do not comply with international tax transparency standards. The EC wants to extend this with the EU principles for fair tax competition. Apparently the EC had to block certain projects from International Financial Institutions (IFI, e.g., the European Investment Bank (EIB), and the European Bank for Reconstruction and Development (EBRD)) because they involved complex tax arrangements through harmful or no-tax regimes in third countries.

5) **A new screening and listing process of third countries**
The EC proposes a new approach for third countries who refuse to comply with the tax good governance standards. In the EC’s view the EU needs stronger instruments to ensure a global level playing field. An update of the EC’s controversial June 2015 list of non-EU country non-cooperative tax jurisdictions is published online in an interactive map. According to the EC this list is an interim solution towards the goal of a common EU system for assessing, screening and listing third countries:

- The scoreboard approach of the Staff Working Document will be used for identifying screening priorities. The first finding based on this approach will be presented to the Code of Conduct group in fall 2016.
- Next, Member States should decide which jurisdictions will be assessed against the good governance criteria. The EC will carry out the assessment with the Code of Conduct Group.
- Finally, Member States will decide which jurisdictions will qualify as problematic and will be added to the list.

The Communication does not, however, address the counteraction to take against listed countries. Options could include withholding taxes and non-deductibility of costs for transactions with listed jurisdictions. Member States need to decide on the counter-measures before the end of 2016.

**Observations:** The EC has set out clearly its view on good tax governance. Once agreed upon by Member States (the foreseen decision-making process is however not very clear), a first logical step would be to apply the criteria in the EU and for decisions on the investments of EU funds. However, the EC, even within the EU itself, will not be able to legally enforce this framework with respect to the criteria that are not legislated via hard law, such as the soft law criteria provided for in the Code of Conduct on Business Taxation. Although many of those criteria are similar to the ones that the OECD used in its 1998 Report on harmful tax competition, the vast majority of the third countries, especially developing countries, have not participated in setting these criteria, nor have they subscribed to those criteria. The timing of the listing process and the planning of the assessment of third countries is very enlightening. The assessment criteria go far beyond the OECD’s BEPS recommendations (e.g., the absence of a withholding tax on interest and royalties are criteria). In the proposed timeline, third countries seem to be given some time to implement the BEPS agenda before they will be assessed. However, both the timeline and criteria are likely to cause resistance, certainly with countries that are not members of the OECD or G20.

**The takeaway**
The EC sets out a very ambitious agenda and wants the EU to lead by example.

The proposals, particularly on the ATA Directive, will almost certainly generate significant discussion amongst the Member States. A number of the elements would require major changes to Member States existing rules. Further, there are no transitional rules.

The amending Directive to enforce CBCR is likely to be fast-tracked and may be adopted within months, so that it can enter into effect at the earliest on 1 January 2017. It would require reporting for fiscal years beginning from 1 January 2016 (first reports submitted by MNEs from 1 January 2017 and first items shared by tax authorities from 1 April 2017).

The Recommendation on treaty abuse and PE status is relatively straightforward and may not prove to be particularly controversial. However, it may progress at the same pace as the ATA Directive, enabling an overall discussion of BEPS-related measures.

The Dutch Council Presidency is likely to push extremely hard to get the ATA Directive adopted by October of this year and published formally by 1 January 2017 to allow Member States to have the Directive transposed into their domestic laws by 1 January 2018. Adoption needs to be unanimous. There seems to be an amount of political support for the Directive, but it would not be surprising if it were reduced in scope from these initial proposals. It could even be split into constituent parts and some agreed ahead of others. A possible timeline for progress on the ATA Directive is set out below.
The criteria for tax good governance logically follow from the work that has been done by the G20, OECD, FATF and the Global forum on transparency and exchange of information. In the area of fair tax competition, the EC wants third countries to comply with the criteria of the Code of Conduct for Business taxation. The lack of involvement of many developing countries in the standard setting by the OECD and the EU is likely to cause some resistance in accepting tax good governance clauses. This may also explain the EC statement that “EU efforts to insert a meaningful tax good governance clause into bilateral agreements have had mixed success”.

The special attention the EC gives to developing countries is clearly important. Domestic revenue mobilisation (DRM) is seen as a key element for development of democracies and for eradicating poverty. Those are important factors that multinational enterprises consider when they decide to invest in a country. Once countries become attractive places for multinational enterprises, economic growth will most likely follow. The EC stipulates that inclusive international coordination and co-operation is paramount.

There is a wide range of stakeholders in ATAP and engaging with them all will involve considerable effort. However, that must be the goal as matters develop if we are to get a workable set of outcomes. Some elements of the package may progress more quickly but they will be less effective if the package as a whole cannot be tailored to meet the Member States’ needs and, through the wider consultations that they have been pursuing, with taxpayers’ commercial considerations for innovation, growth and jobs. The EC mentions the importance of the EU remaining competitive and attractive to foreign investment and it will be necessary to consider the proposals carefully in this regard.

A possible timeline for actions on the ATA Directive is as follows:

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
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<tbody>
<tr>
<td>Draft ATA Directive sent to Member States (ECOFIN) Council</td>
<td>days after formal adoption</td>
</tr>
<tr>
<td>Additional planning of ECOFIN Council meetings and working groups on</td>
<td>1 Feb. 2016</td>
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<tr>
<td>ATA Directive by 6-monthly rotating EU Council Presidency:</td>
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<td>Netherlands 1st half of 2016, Slovakia 2nd half of 2016 (next Malta)</td>
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<tr>
<td>Start of a series of (ECOFIN) Council High Level Working Party (Taxation) meetings with senior tax policy representatives of the Finance Ministers (first meeting on 1 Feb.), and Working Party on Tax Questions (Direct Taxation) meetings at fiscal attaché technical expert level (first meeting on 9 Feb.). All meetings are chaired by the Council Presidency.</td>
<td>1 Feb. 2016</td>
</tr>
<tr>
<td>EU Council Presidency sets agenda, pace and number of meetings, can propose splitting-up the Directive (as with the Parent-Sub Directive), and broker political compromise.</td>
<td>days after formal adoption – last week of Mar. 2016</td>
</tr>
<tr>
<td>Draft ATA Directive sent to national parliaments for EU law subsidiarity principle and proportionality test (8-week ‘yellow card’ procedure: has EC over-stepped competences under EU law by proposing EU-level action?)</td>
<td>days after formal adoption – May/Jun. or Sep./Oct. 2016</td>
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<td>1/3 minority of national parliaments objecting could delay EU law-making process for a few months and could force EC to formally review its proposal.</td>
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<tr>
<td>EP ECON inter-parliamentary debate (EP and 28 national parliaments): ‘The follow-up on BEPS’</td>
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<tr>
<td>Informal ECOFIN Council meeting in Amsterdam (poss. informal discussion).</td>
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<tr>
<td>ECOFIN Council meeting: policy debate and likely earliest date for EU-28 political agreement in Council on the draft ATA Directive (or some of the sub-parts should the Directive be split).</td>
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</tbody>
</table>
If political agreement reached: formal adoption in a forthcoming ECOFIN Council by unanimity.

ECOFIN Council meeting: second likely earliest date for EU-28 political agreement in Council on draft ATA Directive (or some of the sub-parts).


Poss. EU-28 political agreement on draft ATA Directive.

Translation of ATA Directive into all official languages of the EU.

Poss. ECOFIN Council formal adoption of ATA Directive by unanimity.

Publication in the EU’s Official Journal. Directive formally enters into force 20 days after publication.

Deadline for transposition into EU-28 domestic legislation of the ATA Directive.


1 Jul. 2016

Sep./Oct. 2016

Nov. 2016


Dec./Jan. 2017

1 Jan. 2018

Let’s talk

For a deeper discussion of how these issues might affect your business, please call your usual PwC contact. If you don’t have one or would otherwise prefer to speak to one of our global specialists, please contact one of the below:

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