European Commission

Explanatory meeting
Albania and North Macedonia
Corporate Tax Directives

Brussels, 3 June 2019

Unit D1 – Company Taxation Initiatives

DG Taxation and Customs Union (TAXUD)

These slides accompany the explanation of the acquis to Albania and North Macedonia and can only be used for that purpose. Their content is subject to further development of the acquis and interpretation by the Court of Justice of the European Union.

Anti-Tax Avoidance Directive 1 & 2

ATAD 1

Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

ATAD 2

Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

ATAD

- *Anti-Tax Avoidance Directive*
- *EU's response to BEPS to tackle aggressive tax planning.*
- *Most MS have committed to implement BEPS*
- *To avoid divergent implementation in MS*
- *Principle based*
- *Minimum standard*
- *To address most widespread forms of tax avoidance*

ATAD

COM proposal included 6 provisions:

- *Interest limitation (BEPS Action Item 4)*
- *Exit taxation*
- *Switch-over clause*
- *GAAR*
- *CFC rules (BEPS Action Item 3)*
- *Hybrid mismatch rules (BEPS Action Item 2)*

ATAD

- *Switch-over clause was dropped.*
- *Several options have been included, in particular on interest limitation and CFC rules.*
- *Rule for addressing hybrid mismatches between MS only.*

ATAD

- *Adopted by ECOFIN Council on 12th July 2016.*
- *Implementation in MS' laws before 1st January 2019.*
- *ECOFIN Council statement to address hybrid mismatches with 3rd countries as well.*

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Scope

- **All taxpayers** that are subject to **corporate tax** in one or more Member State
- They may be:
  - **established under the laws** of a MS
  - **resident** for **tax purposes** in a MS
- **PEs** in a Member State other than that of the Head Office.
- **PEs** in a Member State of entities which are tax resident in a **third country**.
- **Transparent entities** fall **outside the scope** of the Directive – unless treated as corporate taxpayers under national law.

Minimum standard - Art. 3

- Aim:
  - to provide a **minimum level of protection** to the internal market; and
  - to **strengthen the average level of protection** against aggressive tax planning in the EU

- Rules should not fall below the standard of the OECD recommendations

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Interest Limitation – Art. 4 (i)

- Interest costs are generally deductible from taxable income
- MNEs take advantage of the high mobility of debt to shift income – in the form of inflated interest payments - towards low-tax jurisdictions
- The group reduces its overall tax burden
- Both the **BEPS reports and CCCTB proposals** suggest introducing a method for limiting the deductibility of net interest expenses (**'exceeding borrowing costs'**)
- The rule applies across the board – no discrimination risks

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Interest Limitation – Art. 4 (ii)

- Underlying principle: financial costs may only be fully deductible insofar as a company receives financial revenues

- **Exceeding `borrowing costs´:**
  - subject to limitation referring to **30%** of the taxpayers earnings before interest, tax, depreciation and amortisation (tax-adjusted **EBITDA**); or
  - up to a **safe harbour** of EUR 3 million, whichever allows higher deductibility.
- Concept of a **tax group** and

Interest Limitation – Art. 4 (iii)

- Possibility of full deductibility of interest:
  - **Safe harbour**
  - **Standalone** company waiver
  - **Loans for public benefit** infrastructure
- Two possible 'escape' clauses: the **'group ratio'** or the **'equity escape'** group carve-out
- Waiver for **financial undertakings**
- **Grandfathering clause** for existing loans – without extension of the benefit in the event of subsequent modification

Exit Taxation – Art. 5 (i)

- Transfers of assets or tax residence out of the tax jurisdiction of a Member State; disposals of assets are not included in the scope

- **Objective:** to prevent the risk whereby assets, expected to generate high income, are moved to low-tax jurisdictions to be sold later and realise a high capital gain which will be low-taxed.
- **Transfers covered:**
  - Assets from Head Office in the EU to PE in another MS or 3rd country; transfers of the whole business of a PE;
  - Tax residence to another MS or 3rd country, except if a PE is left behind with assets effectively connected to it.

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Exit Taxation – Art. 5 (ii)

- **Within the EU/EEA:**
  - **Deferral** of the payment of tax by arranging instalments over 5 years
- **Prevention of double taxation:** destination MS shall accept the market value determined by MS of the taxpayer as a starting value therein.

- **No obligation to apply exit taxation:**
  - **Tax exempt assets;**
  - **Financial assets:** no exit tax on temporary asset transfers and as long as the assets are due to revert to the departing MS.

General Anti-Abuse Rule – Art. 6 (GAAR)

- **Aim:** to tackle abuses that have not yet been dealt with through specifically targeted provisions – designed to cover gaps

- **Within the EU:**

  (a) application to be limited to ‘non-genuine arrangements‘ (without valid commericial reasons); use of term ‘main or one of the main purposes' – **substance test**

  (b) Taxpayer should have the right to choose the most tax efficient structure for its commercial affairs

- **Indistinct application** domestically and cross-border

Controlled Foreign Company Rules – Art. 7 (CFC) (i)

- **Aim:** to discourage shifting large profits out of a highly-taxed parent company towards subsidiaries in low-tax jurisdictions

- Schemes often involve shifts of mobile passive income (e.g. royalties) within a group, based on transfers of intangible or financial assets to CFCs

- **Outcome:** to reduce overall tax burden of the group

CFC Rules – Art. 7 (ii)

- Common requirements for **establishing** that a **CFC** exists:

  (a) A **participation of more than** 50% in the controlled subsidiary, directly or indirectly;

  (b) **Low level of taxation** in the third country or Member State where the subsidiary is tax resident,

  i.e. an effective corporate tax rate **lower than 50%** of the **effective** corporate tax **rate** in the Member State of the taxpayer.

- CFC rules also apply to PEs.

CFC Rules – Art. 7 (iii)

- To compute CFC income for re-attribution, rules may target:
  - (i) specific categories of income (**'tainted' income**); or
  - (ii) income **artificially diverted** to the subsidiary
- In ATAD, MS may opt between options (i) & (ii) for computing the income of a CFC

CFC Rules – Art. 7 (iv)

- **Policy option (i)**
  - **List of categories** that income is derived from;
  - Escape clause: if **CFC carries on substantive economic activity – vis-à-vis third countries**, no obligation for MS to apply escape clause
- **`Throw-out´ clause:** MS may not treat an entity or PE as a CFC if:
  - **not more than 1/3** of the income falls within one or more of the listed types of income
  - **financial undertakings** earn not more than 1/3 of their income through associates

CFC Rules – Art. 7 (v)

- **Policy option (ii)**
  - Re-attributes to the MS of the parent income generated in the subsidiary from **assets and risks which are effectively managed through significant people function (SPF) in the parent's** MS;
  - Amounts beyond 'arm´s length' are **wholly artificial;**
  - **Exemptions** apply to low accounting profits and low profit margin.

ATAD 2

- *Following the ECOFIN Council statement*
- *Proposed by COM in October 2016.*
- *COM proposal covered a broad range of hybrid mismatches as addressed in the OECD report.*

ATAD 2

- *Additional mismatch situations now covered, including those involving branches.*
- *Time-limited option to exclude regulatory capital instruments now included.*

- *ECOFIN Council agreed on a compromise on 21st February 2017.*
- *Implementation in MS' laws before 1st January 2020.*

Further agreed provisions:

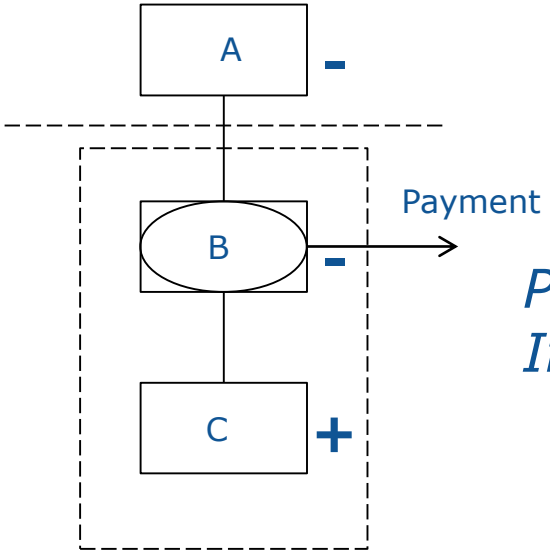
- *Definitions Article (2) defining a hybrid mismatch.*
- *Operative rule (Article 9) neutralising the hybrid mismatch.*
- *Specific rules on reverse hybrid entities (9a) and dual resident entities (9b).*

Hybrid mismatch - definition

- *Situation involving a corporate taxpayer*
- *Only mismatches between associated enterprises*
- *Resulting in a deduction without inclusion (D/NI) or to a double deduction (DD).*
- *Taking into account dual inclusion income*
- *Various situations defined in Article 2 9(a) through 2 9 (g).*
- *Imported mismatches also covered (Art. 9-3)*

Hybrid mismatch – Neutralising DD

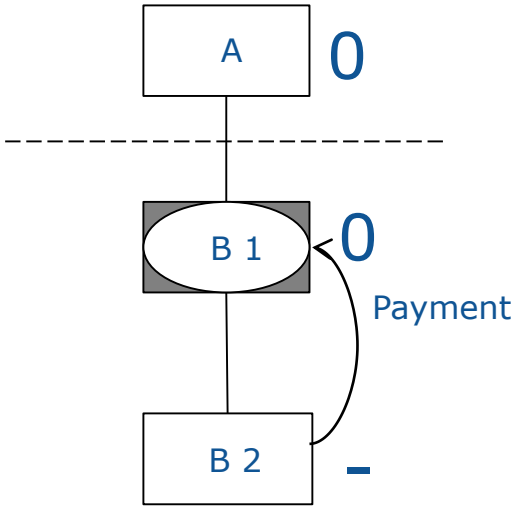
- *Deduction shall be denied*
- *Primary rule: in MS that is investor jurisdiction*
- *Secondary rule: in MS that is payer jurisdiction*



Primary rule: A should deny deduction.
If A does not deny deduction, B should deny.

Hybrid mismatch – Neutralising D/NI

- *Primary rule: deduction shall be denied in MS that is payer jurisdiction*
- *Secondary rule: payment shall be included in MS that is payee jurisdiction*



Primary rule: B 2 should deny deduction. If deduction is not denied, payment shall be included by A.
NB: secondary rule is optional

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Anti-Tax Avoidance measures in the EU

ATAD 1

7.2016: ATAD 1 (Dir. 2016/1164) Minimum standard: MSs may apply stricter rules

1. Interest limitation rule.

Applies 1.2019

Net interest payments are only deductible up to 30% EBITDA.

**Safe harbour of € 3 000 000.*

**Group carve-out rule based on debt to equity ratio or the group's borrowing costs.*

2. Exit tax.

Applies 1.2020

Exit tax on unrealised capital gains built in transferred assets.

** Applies when assets are moved out of MSs without disposing them.*

3. GAAR

Applies: 1.2019

General Anti-Abuse Rule.

** Serves as a backstop to counter artificial arrangement put in place to obtain a tax advantage.*

4. CFC

Applies: 1.2019

Controlled Foreign Company

**Taxes income from mobile passive assets shifted to subsidiaries in low tax jurisdictions.*

ATAD 2

5.2017 Dir. 2017/952

Amendment to ATAD

5. Anti-hybrid mismatch rules

Applies: 1.2020

** Includes rules to counter hybrid mismatches in the EU and with 3rd countries.*

** Hybrid mismatches result from the difference in qualification of entities or payments leading to a double deduction or a deduction without any taxation.*