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.

Introduction

Directives to harmonize corporate taxation:

→ binding legislation for the Member States
→ to implement at the time of accession

Legislative basis: Art. 115

"The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal Market"

Introduction

- Elimination of distortions/obstacles for cross-border economic activities
- Objective: no obstacles, i.e. similar treatment, to cross-border activities as internal ones

Introduction

- Compared with indirect taxation, a minor degree of harmonisation has taken place in direct taxation

- 3 Directives – Elimination of double taxation:
  - Merger Directive
  - Parent-Subsidiary Directive
  - Interest and Royalties Directive

- Anti Tax-Avoidance Directive 1 & 2

European Commission

The Merger Directive

Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States *(OJ L 310, 25.11.2009)*

The Merger Directive

Purpose (recital 2):

'To allow enterprises to adapt to the requirements of the common market,

to increase their productivity, and

to improve their competitive strength at the international level'

The Merger Directive

- Restructuring operations normally trigger the taxation of capital gains/hidden reserves
- Merger Directive provides for (recital 5):
  - Tax deferral by a common system to cross-border transactions and eliminates distortions
  - Safeguards the financial interests of Member States

The Merger Directive

Scope (article 2)**:**

Merger

Division

Partial division

Transfer of assets

Exchange of shares

Transfer of registered office of SE/SCE

The Merger Directive

Scope:

- Must involve companies from at least two MS, but in the case of transfer of registered office (Article 1),

- Covers the types of company which are:

a) listed in the Annex,
b) tax resident in a Member State, and
c) subject to corporation tax (Article 3).

The Merger Directive

Art. 4 – Deferral of taxation on assets and liabilities

- Deferral (not exemption) until subsequent disposal of asset by receiving company
- Permanent establishment condition: assets and liabilities are effectively connected to a permanent establishment in MS of transferring company
- Receiving company takes over tax values of transferring company (book value roll-over)

The Merger Directive

Art. 5 – Carry-over of provisions and Reserves

Permanent establishment "replacing" transferring company enters such reserves in its accounts,

The permanent establishment assumes the rights and obligations of the transferring company

The Merger Directive

Art. 6 - Takeover of losses

- Loss carry-forwards of transferring company
- Are taken into account (roll-over) at level of receiving PE
- Where such a relief is granted in purely domestic situations

Art. 7 – cancellation of holding

Where receiving company already holds shares in transferring company, and those shares are cancelled as a result of a merger or division

No taxation of such "cancellation" gains

- But: Member State may tax where holding does not exceed 10%

The Merger Directive

Art. 8 – Allotment of new Securities to Shareholders when a merger, division or exchange of shares takes place

The following may not give rise to any taxation:

- Mergers → exchange of securities held by the shareholders of the transferring company for securities of the receiving company
- Divisions → exchange of securities held by the shareholders of the divided company for securities of the companies receiving the assets of the divided company
- Exchange of shares → the exchange of the securities transferred by the shareholders of the acquired company to the acquiring company in return for the latter's securities

The Merger Directive

Art. 8

- Taxation only deferred, provided that shareholder does not attribute a higher value to the shares received than the tax value of the shares transferred (book-value roll-over condition)

- Any cash payment can be taxed immediately

The Merger Directive

Art. 9 – Transfer of assets

Following articles apply to transfer of assets:

- Art. 4 (deferral of taxation on assets connected to a PE)
- Art. 5 (carry-over of provisions and reserves) and
- Art. 6 (takeover of losses)

The Merger Directive

Art. 10 – Triangular cases:

- Where a PE in a third Member States is involved in operation, the Member State in which PE is situated may not tax any hidden reserve

- MS of the transferring company:

  - May exempt. If it applies exemption, the Member State of the transferring company may 'reinstate' the losses of the PE that have been set off against the profits of the transferring company but not recovered, or

  - Tax and give notional credit

The Merger Directive

Transparent entities:

- ✓ Problem arises where difference in qualification:
  - Member State of residence: company is opaque and in the annex to the Directive
  - A different Member State treats as transparent

Articles 4 and 8 provide for deferral on the taxation of capital gains on assets or shares of the shareholders; or on those having an interest on the shareholder

The Merger Directive

Transparent entities

Article 11

- Member States may derogate and tax those shareholders
- Notional tax credit

The Merger Directive

Transfer of registered office

Deferral is granted under conditions similar to those applying to other operations covered by Directive

- Art. 12: corresponds to Art. 4 – Deferral of taxation on assets and liabilities
- Art. 13.1: corresponds to Art. 5 - Carry-over of provisions and reserves
- Art. 13.2: corresponds to Art. 6 - Takeover of losses
- Art. 14: no taxation of shareholders for deemed "liquidation" gains

The Merger Directive

Art. 15.1 – Anti Abuse provisions

If the operation has as its principal objective or as one of its principal objectives tax evasion or tax avoidance, Member States may:

- Refuse to apply the tax benefits laid down by the Directive, or
- Withdraw the benefit

- Lack of a valid commercial reason
- But: ECJ interprets anti-abuse rules strictly

The Parent-Subsidiary Directive

Council Directive 2011/96/EC of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States

(OJ L 345, 29.12.2011)

The Parent-Subsidiary Directive

Purpose (recitals)

- Create within the EU conditions analogous to those of an internal market;
- Ensure the establishment and effective functioning of the internal market;
- Introduce with respect to group of companies of different Member States, tax rules which are neutral from the point of view of competition;
- In order to allow enterprises to adapt to the requirements of the internal market, to increase productivity and to improve competitive strength

The Parent-Subsidiary Directive

Rationale

Three layers of taxation:

- Corporate income tax on the profits of the subsidiary
- Withholding at source on the distributed profits received by the parent company
- Corporate Income tax on the profits received by the parent company

Aim

- Abolition of withholding taxes on dividend distributions
- Elimination of economic double taxation of profits of a subsidiary

European Commission

The Parent-Subsidiary Directive

Scope

- Must involve companies from at least two MS (Art. 1),
- Parent – subsidiary (Art. 3):
  - minimum 10% shareholding
  - MS →minimum 2 years holding period
- Covers profit distributions received by a PE of the parent company (triangular case, Art. 1),
- Companies (Art. 2):
  - listed in the Annex,
  - tax resident in a Member State, and
  - subject to corporation tax, without the possibility of an option or of being exempt

The Parent-Subsidiary Directive

Structure

- ✓ MS of subsidiary -> must exempt profit distributions from withholding tax (art. 5),

- ✓ MS of parent company (art.4):
  - must exempt distributions received by parent, but (hybrid financing)

  -> *refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary, and tax such profits to the extent that such profits are deductible by the subsidiary* (Directive 2014/86/EU)

  - or tax, but give credit for underlying corporate tax paid by the direct or any <u>indirect</u> subsidiaries (lower-tiers)

  - ➢ It is an ordinary credit - limited to amount of tax due in MS of parent on distributions received by parent

The Parent-Subsidiary Directive

Structure

MS of parent company (art.4):

- Any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company,

- Management costs relating to the holding are fixed as a flat rate, the fixed amount may not exceed 5 % of the profits distributed by the subsidiary

The Parent-Subsidiary Directive

Transparent entities

- State of residence of subsidiary: opaque entity
- But: state of residence of parent company treats subsidiary as transparent on the basis of that State's assessment of the legal characteristics of that subsidiary arising from the law under which it is constituted (no – CFC):
  - ✓ Immediate taking into account of income of subsidiary
  - ✓ But: ensuring elimination of double taxation by applying exemption or credit method!

The Parent-Subsidiary Directive

Anti-abuse

"This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse" (Art 1.2)

Best- provision

"This Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends" (Art. 7.2)

The Interest and Royalties Directive

Council Directive 2003/49/EC of 3 June 2003 on the common system of taxation applicable to interest and royalty payments made between associated companies of different Member States *(OJ L 157, 26.6.2003)*

The Interest and Royalties Directive

Purpose (recitals)

Taxation of cross-border/intra EU payments = domestic payments:

- Elimination of juridical double taxation
- Elimination of cash-flow disadvantages
- Be taxed once in a Member State
- "*Burdensome administrative formalities*" → is that achieved?

Scope

- ✓ Between EU associated companies
- ✓ From or to EU permanent establishments

The Interest and Royalties Directive

HOW?

- ✓ Exemption of withholding tax at source
- ✓ Ensuring the payment is taxed once in a Member State, where the related expense is deductible

The Interest and Royalties Directive

- Payments between associated companies (art. 1.7)

- Company of a Member State (art. 3.a):
  - Legal form listed in the annex to the Directive
  - Resident in a Member State for tax purposes
  - Subject to corporation tax

The Interest and Royalties Directive

Associated companies (art. 3.b)

- Holding:
  - Direct
  - Minimum of 25%
  - 2 year period (MS)

- Cover payments between two subsidiaries of the same parent company- Payer and beneficiary established in different Member States but parent company may be from one of those two Member States

- REMEMBER: Option to replace minimum holding of the capital by voting rights

The Interest and Royalties Directive

Definition of permanent establishment

Article 3 (c): the term ‘permanent establishment’ means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on

Differs from **OECD Model** Tax Convention:

- No list of examples
- No building site or construction or installation project ?
- Does not exclude ancillary or preparatory activities
- No dependent agent

The Interest and Royalties Directive

Interest (art. 2.a)

"Income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from bonds and debentures, including premiums and prizes attaching to such bonds or debentures"

- Closed definition, no reference to DTC or domestic definitions: uniformity and legal certainty vs extension
- Different from the savings Directive

The Interest and Royalties Directive

Royalties (art. 2.b)

"Payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, scientific, work , including cinematograph films and software, any patent , trade mark, design or model, plan, secret formula or process, or for the use of or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience; payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties."

- As OECD Model definition (Art. 12.2), but software and use of industrial, commercial and scientific equipment
- Closed definition, no reference to DTC or domestic definitions: uniformity and legal certainty vs. extension

The Interest and Royalties Directive

Exclusion of payments as interest or royalties (art. 4.1)

The Directive → Source State may not apply the benefits of the Directive to:

- Payments reclassified as distribution of profits
- Debt-claims with a right to participate in the debtor's profits
- Debt-claims entitling the creditor to exchange interest for profits
- Debt-claims without a repayment provision or when repayment is due more 50 years

The Interest and Royalties Directive

Exclusion of payments as interest or royalties (art. 4.2)

"Where, by reason of a special relationship between the payer and the beneficial owner of interest or royalties, or between one of them and some other person, the amount of the interest or royalties exceeds the amount which would have been agreed by the payer and the beneficial owner in the absence of such a relationship, the provisions of this Directive shall apply only to the latter amount, if any."

The Interest and Royalties Directive

Anti-abuse rule (art. 5)

*"1. This Directive shall not preclude the application of **domestic or agreement-based** provisions required for the prevention of **fraud or abuse**.*

*2. Member States may, in the case of transactions for which the **principal motive or one of the principal motives is tax evasion, tax avoidance or abuse**, withdraw the benefits of this Directive or refuse to apply this Directive."*

The Swiss agreement

Art. 9 → dividends from subsidiaries to parent companies (25%), interests and royalties paid between associated companies (25%), involving one Swiss company are exempt from withholding tax.