Tax News Bulletin
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EC releases Anti Tax Avoidance Package

On 28 January 2016, the European Commission ("EC") released its Anti Tax Avoidance Package ("the Package"). The Package contains proposals for concrete measures to prevent aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the EU.

The Package is a continuation of the Action Plan released by the EC on 17 June 2015[1]. The EC considers the Package as a half way house to a European Common Consolidated Corporate Tax Base ("CCCTB"), the implementation of which the EC continues to aspire.

Although the European Parliament is yet to be consulted, and the proposals are yet to be adopted by the European Council, in the Netherlands, the Package has already met firm criticism from various stake holders. In their view, the Package is harmful to the Dutch investment climate, as well as to the competitiveness of the EU as a whole. Moreover, it is feared that it will deter multinationals that do not engage in aggressive tax planning and that it will cause double taxation. The EC dismisses the criticism by saying that a lot of analysis and consideration has gone into the Package, and that time is of the essence since some member states have already started to implement parts of the OECD's BEPS Action Plans. The EC fears fragmentation of the internal market if the EU does not take its own measures now.

The Package consists of:

1. A draft Anti Tax Avoidance Directive
2. A Recommendation on Tax Treaties
3. A Revised Administrative Cooperation Directive
4. A Communication on External Strategy, and
5. Some Staff working documents and studies on aggressive tax planning

[1] For details on the Action Plan of 17 June 2015, we refer to our tax news bulletin of 18 June 2015, which can be found on our website www.ohp.nl

Draft Anti Avoidance Directive

The Draft Anti Avoidance Directive ("the Directive") lays down anti-tax avoidance rules in six specific fields: deductibility of interest, exit taxation, a switch over clause, a general anti abuse rule ("GAAR"), controlled foreign company ("CFC") rules, and a framework to tackle hybrid instruments.

Deductibility of interest will be limited to the higher of 30% of EBITDA or EUR 1 million. A higher limit applies in case the taxpayer has an equity-to-asset ratio equal to or higher than the group of which the taxpayer forms part. For financial institutions, a temporary exemption is envisaged since the nature of their business requires more detailed consideration. Both excess EBITA (unused absorption) and excess interest expense (insufficient absorption) may be carried forward.

Exit taxation shall apply in case of migration of the tax residence of a company, or a permanent establishment, or a transfer of assets from a head office to a PE or vice versa, or transfers of assets from one PE to another PE. Payment may be deferred over five annual installments.

Under the **switch over clause**, a participation exemption is substituted by taxation with a credit ("ordinary credit" i.e. up to the amount of tax due in the recipient member state) for foreign tax for income from participations in third countries (non-member states) if such income was subject to tax at a rate lower than 40% of the rate of the recipient member state. The switch over does not apply in case of operating losses or capital losses on the disposal of shares in a participation, to avoid importation of losses.

The GAAR aims to "ignore non-genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the purpose of the otherwise applicable tax provisions". An arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. The GAAR is almost exactly the same as that introduced into the EU parent subsidiary directive in 2015 (although the EU PSD directive speaks of main purpose in stead of essential purpose, a different meaning is probably not intended).

Under **the CFC rules**, income of a controlled participation (50% of voting power or 50% of capital or 50% of profit rights, owned directly or indirectly, by the taxpayer alone or together with associated companies) will be subjected to current taxation at the level of the parent company, if:

1. the profits are subject to an ETR which is lower than 40% of the ETR of the parent company, and
2. more than 50% of the income from the controlled participation falls within the following categories: interest or income from other financial assets, royalties or other income from IP or tradable permits, dividends and capital gains from shares, income from financial leasing, income from immovable property, income from insurance, banking and other financial activities, income from services rendered to the tax payer or its associated enterprises.

For CFC's resident in the EU or EEA, and for PE's resident in the EU or EEA but owned by third countries, the CFC rules will apply only if the establishment of the CFC is wholly artificial or if the CFC

engages in non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage[2].

Under the **hybrid mismatch rule**, the legal characterization given to the hybrid entity or hybrid instrument by the member state in which the payment has its source (source state) must be followed by the other member state (residence state).

Recommendation on Tax Treaties

This part of the Package encourages member states to insert a modification into the principal purpose test in their double tax treaties. The modification is comparable to the language mentioned above under the GAAR. It further encourages member states to make use of the new proposed provisions to article 5 of the OECD Model Convention as drawn up in BEPS Action 7.

Revised Administrative Cooperation Directive

The Revised Directive extends the automatic exchange of information to include country-by-country reporting.

Communication on External Strategy

This communication sets out a common external strategy for a more efficient and fair corporate taxation in Europe, meant to avoid patch work measures by individual member states. It includes good governance criteria, increased tax transparency, avoiding harmful tax practices (e.g. modified nexus approach for special tax regimes), state aid provisions, and a common assessing (screening) and listing of non-cooperative (in terms of failure to comply with good governance standards) third countries.

The **Study on Aggressive Tax Planning** looks at Member State's corporate tax rules that can facilitate aggressive tax planning and key structures used by companies to avoid taxation.

The **Staff Working Document** is a communication from the EC to the European Parliament and the Council. Among other things it explains the issues identified, the process and its history, and the Anti Tax Avoidance Package.

Next Steps

The two legislative proposals of the Package (Anti Tax Avoidance directive and the Revised Administrative Cooperation Directive) will be submitted to the European Parliament for consultation and to the Council for adoption. The Council and Parliament should also endorse the Tax Treaties

[2] In those cases, only the income generated through assets and risks which are linked to significant people's functions carried out by the controlling company shall be included in current taxation.

Recommendation and Member States should follow it when revising their tax treaties. Member States should also formally agree on the new External Strategy and decide on how to take it forward as quickly as possible once it has been endorsed by the European Parliament.

The source documents can be found at http://europa.eu/rapid/press-release_IP-16-159_en.htm

If you have any questions, please contact your trusted tax advisor at Otterspeer, Haasnoot & Partners.