The EU Anti-Tax Avoidance Directive (ATAD): the next step of positive harmonization

Athens Law School
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Anti-Tax Avoidance Directive (ATAD)
Tackling tax avoidance – Why it matters? #fairtaxation
Anti-Tax Avoidance Directive (ATAD)
Corporate tax avoidance - #levelplayingfield #fairtaxation
Anti-Tax Avoidance Directive (ATAD)
Corporate tax avoidance - #stephsbiscuits
Anti-Tax Avoidance Directive (ATAD)

Introduction

- 12 July 2016: Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
- Legal basis: article 115 TFEU (unanimity)

*Without prejudice to Article 114,* 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.**

- Difficult negotiation process
- Minimum harmonisation Directive
- Different implementation deadlines – many options to MSs
**Anti-Tax Avoidance Directive (ATAD)**

**Introduction**

- The ATAD introduced the following set of rules
  1. *Interest limitation rule (or EBITDA rule)*
  2. Rules for exit taxation
  3. General anti-abuse rule (GAAR)
  4. *Controlled Foreign Companies (CFC) rule*
  5. *Rules addressing mismatches between MS*

Rules 1, 4 and 5 were also dealt at the final **BEPS** reports of the OECD
Anti-Tax Avoidance Directive (ATAD)

Introduction

• What is BEPS?
  ✓ Abbreviation of “Base erosion and profit shifting”
  ✓ Tax planning strategies that exploit gaps and mismatches in tax rules to make profits “disappear” for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid.
  ✓ Initiative of the Organization for Economic Cooperation and Development (OECD)
  ✓ 15 OECD’s BEPS action reports
Anti-Tax Avoidance Directive (ATAD)

Introduction

• What is BEPS?
  ✓ Recommendations (soft law) vs hard law
  ✓ See AG Kokott opinion in the pending case C-115/16 (N Luxembourg 1)

50. OECD MTCs are not legally binding, multilateral conventions under international law; they are the unilateral acts of an international organisation in the form of recommendations to its member countries. Even the OECD does not consider these recommendations to be binding; rather, under the OECD Rules of Procedure, the member countries must consider whether their implementation is opportune. This applies a fortiori to the commentaries published by the OECD, which ultimately only contain legal opinions.
Anti-Tax Avoidance Directive (ATAD)
Introduction

EU law and disparities

- EU fundamental freedoms do not provide protection against mismatches between two or more Member States (C-403/03 Schempp)

German resident paying an alimony to his Austrian resident spouse. He could not deduct the alimony payment from his taxable income in Germany.

CJEU: the unfavorable treatment was a consequence of a disparity in the tax law of the two MSs. Austria and Germany applied different tax systems regarding the taxation of alimony in the hands of the recipient.

34 It is settled case-law that Article 12 EC is not concerned with any disparities in treatment, for persons and undertakings subject to the jurisdiction of the Community, which may result from divergences existing between the various Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality (see, to that effect, Case C-137/00 Milk Marque and National Farmers’ Union [2003] ECR I-7975, paragraph 124 and the case-law cited there).
Anti-Tax Avoidance Directive (ATAD)

Introduction

EU law and double taxation

- *Juridical* double taxation (=same person is taxed twice on the same income) *is not protected under EU law* (C-513/04 Kerckhaert-Morres)

The free movement of capital permits a MS to subject domestic dividends and dividends received from companies resident in another MS to the same uniform flat tax rate, *without providing any credit for the withholding tax levied in the other Member State.*

22 Community law, in its current state [...], does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the Community. Apart from [the EU Parent-Subsidiary Directive], the [EU Mergers Directive] and the [Saving Directive – repealed] no uniform or harmonisation measure designed to eliminate double taxation has as yet been adopted at Community law level.
## Anti-Tax Avoidance Directive (ATAD)

BEPS measures: OECD vs EU (1/2)

<table>
<thead>
<tr>
<th>BEPS Action Item</th>
<th>OECD</th>
<th>EU</th>
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<tbody>
<tr>
<td><strong>Action 2</strong>: Neutralise the effect of hybrid mismatch arrangements</td>
<td>Specific recommendations to link the tax treatment of an instrument or entity in one country with the tax treatment in another, to prevent mismatches.</td>
<td>The Anti Tax Avoidance Directive (ATAD) includes a provision to address hybrid mismatches.</td>
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<tr>
<td><strong>Action 3</strong>: Strengthen CFC rules</td>
<td>Best practice recommendations for implementing CFC rules.</td>
<td>The ATAD includes CFC rules.</td>
</tr>
<tr>
<td><strong>Action 4</strong>: Limit base erosion via interest deductions and other financial payments</td>
<td>Best practice recommendations on limiting a company’s or group’s net interest deductions.</td>
<td>The ATAD includes provisions to limit interest deductions, within the EU and externally.</td>
</tr>
<tr>
<td><strong>Action 5</strong>: Counter harmful tax practices more effectively</td>
<td>Tax rulings: Mandatory spontaneous exchange of relevant information. Patent Boxes: Agreement on &quot;Nexus Approach&quot; to link tax benefits from preferential regimes for IP to the underlying economic activity.</td>
<td>Tax rulings: Mandatory automatic exchange of information on all cross-border rulings from 2017 (Directive 2015/2376) Patent Boxes: Member States agreed to ensure that their Patent Boxes are in line with the nexus approach (Code of Conduct Group, 2014).</td>
</tr>
<tr>
<td><strong>Action 6</strong>: Prevent treaty abuse</td>
<td>Anti-abuse provisions, including a minimum standard against treaty shopping, to be included in tax treaties.</td>
<td>The Recommendation on Tax Treaties suggests that Member States introduce a general anti-abuse rule (PPT) in their treaties in an EU-compliant way.</td>
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## Anti-Tax Avoidance Directive (ATAD)

BEPS measures: OECD vs EU (2/2)

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<td><strong>Action 7</strong>: Prevent the artificial avoidance of PE status</td>
<td>Definition of Permanent Establishment (PE) is adapted in Model Tax Convention, to prevent companies from artificially avoiding having a taxable presence.</td>
<td>ATA Recommendation encourages MSs to use the amended OECD approach for Permanent Establishment.</td>
</tr>
<tr>
<td><strong>Action 8-10</strong>: Assuring that transfer pricing outcomes are in line with value creation</td>
<td>Arm’s Length Principle and Comparability Analysis confirmed as pillars of Transfer Pricing. More robust framework for implementing this standard.</td>
<td>Joint Transfer Pricing Forum (JTPF) working on EU approach to review and update transfer pricing. Work includes looking at more economic analysis in TP, better use of companies' internal systems, and improving TP administration.</td>
</tr>
<tr>
<td><strong>Action 13</strong>: Transfer pricing documentation and country-by-country reporting</td>
<td>Country-by-Country reporting (CbCR) between tax administrations on key financial data from multinationals. Information for tax authorities only – not public CbCR.</td>
<td>ATA Package proposes legally binding requirement for Member States to implement CbCR between tax authorities. Work ongoing on feasibility of public CbCR in the EU.</td>
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<tr>
<td><strong>Action 14</strong>: Make dispute resolution mechanisms more effective</td>
<td>G20/OECD countries agreed to measures to reduce uncertainty and unintended double taxation for businesses, along with a timely and effective resolution of disputes in this area. A number of countries have committed to a mandatory binding arbitration process.</td>
<td>Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union.</td>
</tr>
</tbody>
</table>
Anti-Tax Avoidance Directive (ATAD)

Unilateral BEPS measures

Ireland
- Introduction of CbCR legislation [1-1-2016]
- EU GAAR [1-1-2016]

Netherlands
- Introduction of CbCR legislation [1-1-2016]
- Introduction anti-hybrid rule
- EU GAAR [1-1-2016]

UK
- Commitment to change the PE definition
- Corporation Tax: anti-hybrid rules [1-1-2017]
- Changes to existing CFC rules, enabling legislation and draft regulations [1-1-2016]
- UK diverted profits tax [1-4-2015]

Belgium
- Commitment to change the PE definition [fall 2016]
- Revised administrative circular letter on the definition of a “dependent agent”
- Introduction of new interest/EBITDA ratio [fall 2016]
- Introduction of CbCR legislation [1-1-2016]

Spain
- Amendments to the CIT regarding the anti-hybrid rules [1-1-2015]
- Introduction of limitation on deduction of interest [1-1-2015]
- Introduction of CbCR legislation [1-1-2016]
- Introduction of anti-hybrid rule [1-1-2015]
- EU GAAR [1-1-2016]

Germany
- Australia-Germany tax treaty includes BEPS recommendations on PEs and treaty abuse [17-12-2016]
- Revised Tax Treaty Germany-Austria with changes to the PE definition [12-11-2016]
- Legislation enacted to neutralize the effect of hybrid mismatch arrangements
- Commitment to implement CbCR standards

Luxembourg
- Introduction of anti-hybrid rule [1-1-2016]
- EU GAAR [1-1-2016]

France
- Introduction of CbCR legislation [1-1-2016]
- Introduction of anti-hybrid rule [1-1-2016]
- EU GAAR [1-1-2016]

Italy
- Introduction of CbCR legislation [1-1-2016]
- EU GAAR [1-1-2016]
**Anti-Tax Avoidance Directive (ATAD)**

Introductory comments

- ATAD’s preamble 2

the introduction of these rules was directly justified by the need to **protect** the EU’s **internal market** against **tax avoidance practices**, thereby ensuring **fair and effective taxation** in the Union in a sufficiently coherent and coordinated fashion.

- Need for ensuring that **tax is paid where profits and value are generated**;
- It is essential for the good functioning of the **internal market** that, as a **minimum**, Member States implement their commitments under BEPS and more broadly, take action to **discourage tax avoidance practices** and **ensure fair and effective taxation** in the Union in a sufficiently coherent and coordinated fashion.
Anti-Tax Avoidance Directive (ATAD)
Introductory comments

- Non-transposition/wrong transposition of the ATAD
- “State aid blessing”
- The relationship with the tax treaties
- ATAD and the EU fundamental freedoms
- Proportionality of the ATAD rules
**Anti-Tax Avoidance Directive (ATAD)**

Introductory comments

- **Non-transposition/wrong transposition of the ATAD**

<table>
<thead>
<tr>
<th>ATAD rule</th>
<th>Transposition deadline</th>
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<tbody>
<tr>
<td>Interest deduction limitation</td>
<td>31 December 2018/31 December 2023 for Member States which are currently applying an interest limitation rule which is equally effective to that of the ATAD</td>
</tr>
<tr>
<td>Exit taxation</td>
<td>31 December 2019</td>
</tr>
<tr>
<td>GAAR</td>
<td>31 December 2018</td>
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<tr>
<td>CFC</td>
<td>31 December 2018</td>
</tr>
<tr>
<td>Hybrids</td>
<td>31 December 2019/ 31 December 2021 (for reverse hybrid mismatches)</td>
</tr>
</tbody>
</table>
Anti-Tax Avoidance Directive (ATAD)
Introductory comments

• Non-transposition/wrong transposition of the ATAD
  ✓ Infringement proceedings by the European Commission
  ✓ Has ATAD direct effect?
    a) unconditional
    b) sufficiently clear and precise,
    c) rights to EU nationals so they can still invoke the rules before national courts against the Member State
  ✓ Reverse direct effect? (Kolpinghuis, C-80/86)
  ✓ Conform interpretation by the national judge (Marleasing, C-106/89)
Anti-Tax Avoidance Directive (ATAD)
Introductory comments

• “State aid blessing”
  ✓ Can the ATAD rules be attributed to the Member States?
  ✓ In particular:
    - Options included in the ATAD
    - Wrong transposition of the core rules
  ✓ Article 3 of the ATAD (minimum level of protection)
Anti-Tax Avoidance Directive (ATAD)
Introductory comments

• The relationship with the tax treaties

✓ Room for interpretation of the tax treaty?
✓ Treaty override*?
✓ Renegotiation?
✓ However: the EC may initiate infringement proceedings

* Treaty override has been described in a tax context in terms of “the enactment of legislation that is intended to nullify unilaterally the application of international treaty obligations” (OECD)
Anti-Tax Avoidance Directive (ATAD)
Introductory comments

• **ATAD and the EU fundamental freedoms**
  - The ATAD can be tested against the EU fundamental freedoms
    See *Ingrid Schmelz* (C-97/09) and the EU VAT Directive
  - The national measure implementing the ATAD rules can be also tested against the EU fundamental freedoms
    See *Euro Park Service* (C-14/16) and the EU Merger Directive

p. 19: “any national measure in an area which has been the subject of *exhaustive harmonisation* at the level of the European Union must be assessed in the light of the provisions of that harmonising measure, and not in the light of the provisions of primary law”
Anti-Tax Avoidance Directive (ATAD)
Introductory comments

- ATAD and proportionality
  - The ATAD is a result of political compromise and it is logical that some rules may not be proportionate
  - Any rule which is implementing the Directive and the Directive itself should be proportionate
  - What about if the rules give rise to double taxation?
  - Less restrictive measures?
**Anti-Tax Avoidance Directive (ATAD)**

The interest limitation rule - introduction

**Aim**: discourage MNEs from reducing tax base through inflated group financing

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**THE LOW TAX LOANS: Interest Limitation Rules**

**BEFORE**

- A company based in the EU sets up a subsidiary in a low-tax country which provides a loan back to the company or another subsidiary again based in the EU. The EU-based company makes high interest, tax-deductible payments back.

**AFTER**

- Interest limitation rules would limit the amount of interest that a company can deduct. This will increase the amount of tax it pays.
Anti-Tax Avoidance Directive (ATAD)
The interest limitation rule - introduction

Article 4

It builds upon BEPS Action 4

**Aim:** discourage MNEs from reducing tax base through inflated group financing

‘In an effort to reduce their global tax liability, groups of companies have increasingly engaged in BEPS, through excessive interest payments. The interest limitation rule is necessary to discourage such practices by limiting the deductibility of taxpayers' exceeding borrowing costs.’

Applicable to **group** interest and **third party** interest (“exceeding borrowing costs”)

**Definitions of article 2 – all forms of debt**

**German EBITDA rule was** served as an example
Anti-Tax Avoidance Directive (ATAD)
The interest limitation rule - introduction

• Maximum of 30% of (tax) ‘EBITDA’ per taxpayer
• What is EBITDA? (Article 4 par. 1)

‘taxable earnings before interest, tax, depreciation and amortisation’

NL
BV
FR
SA
BANK NV

BV holds a participation and pays interest on a loan to a bank.

Can BV deduct interest?
**Anti-Tax Avoidance Directive (ATAD)**
The interest limitation rule - introduction

- **Excess of ‘exceeding borrowing costs’** (article 4 par. 6)
  1. Unlimited carry forward
  2. Unlimited carry forward and 3 years carry back
  3. Unlimited carry forward and 5 years carry back

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BV holds a participation and pays interest on a loan to a bank.

Can BV deduct interest?
Anti-Tax Avoidance Directive (ATAD)
The interest limitation rule – standalone entities option
Article 4(3)(b)

• Exception for standalone entities (option)

• A standalone entity means:
  - Not part of a consolidated group for financial accounting purposes
  - Has no associated enterprise
  - Has no permanent establishment
Time for some practical examples
**Anti-Tax Avoidance Directive (ATAD)**

**Exit taxation – introduction**

**Aim:** prevent tax base erosion through tax jurisdiction transfers without ownership change/to discourage taxpayers from transferring their tax residence and/or assets for aggressive tax purposes.
Anti-Tax Avoidance Directive (ATAD)
Exit taxation – introduction

• When exit taxation on **unrealized capital gains** is triggered?
  1) Transfer of **assets** from the head office to the permanent establishment in another Member State or in a third country;
  2) transfer of **assets** from the permanent establishment in a Member State to the head office or another permanent establishment in another Member State or in a third country;
  3) transfer of **tax residence** to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State;
  4) Transfer of the **business carried on by the permanent establishment** from a Member State to another Member State or to a third country.
Anti-Tax Avoidance Directive (ATAD)
Exit taxation – introduction

✓ Option for deferral of taxation and payment in installments over 5 years within EU/EEA
✓ Option for charging of interest
✓ Option for requesting a guarantee

✓ Where the transfer of assets, tax residence or the business carried on by a permanent establishment is to another Member State, that Member State shall accept the value established by the Member State of the taxpayer or of the permanent establishment as the starting value of the assets for tax purposes, unless this does not reflect the market value.

→ Avoidance of double taxation
**Anti-Tax Avoidance Directive (ATAD)**

Exit taxation – introduction

- The rules take into account settled CJEU case law in recent years on the subject of exit taxation.
- The right to a deferral of payment for corporate taxpayers, as provided by Article 5 par. 2 of the ATAD stems from *National Grind Indus* (Case C-371/10), as well as the options granted under Article 5 par. 3 of the ATAD to charge interest on the outstanding amount of exit tax or to require a bank guarantee.
- The measure regarding payment in installments spread over five years was found to be compatible with EU law in *DMC* (Case C-164/12) and *VerderLabTec* (Case C-657/13).
Anti-Tax Avoidance Directive (ATAD)
National Grid Indus (C-371/10)

• The issues were:

(i) whether a company incorporated under the laws of a Member State which is subject to an exit tax following the transfer of its place of effective management to another Member state may rely on the EU freedom of establishment;

(ii) whether an exit tax is incompatible with the EU freedom of establishment, if it is applied in the circumstances of (i) above, and **without deferment of payment** until the time of realization of capital gains, **and also does not take into consideration subsequent decreases** in value for the calculation of gains relating to business assets which were transferred to the other Member State; and

(iii) whether it is relevant that the exit tax in question relates to a (currency) profit which accrued under the tax jurisdiction of the Netherlands, whereas that profit cannot be reflected under the tax system of the host Member State.
Anti-Tax Avoidance Directive (ATAD)
National Grid Indus (C-371/10)

• Restriction on the freedom of establishment: the transfer of a company’s place of management within the Netherlands does not result in the taxation of unrealized capital gains, whereas the transfer of a company’s place of effective management to another Member State results in immediate taxation of unrealized capital gains → a cash flow disadvantage + deters a company incorporated under the law of the Netherlands from moving its place of effective management to another Member State.

• The imposition of an exit tax may be justified by the need to ensure a balanced allocation of taxing rights between Member States.

• The transfer of the place of effective management of a company of one Member State to another Member State cannot mean that the Member State of origin must abandon its right to tax a capital gain which arose before the transfer.
Anti-Tax Avoidance Directive (ATAD)
National Grid Indus (C-371/10)

• With respect to the proportionality of the exit tax at issue, the Court held that a distinction must be made between (a) the determination of the amount of the tax, and (b) the recovery of the tax.

(a) The determination of the amount of the tax

1. It is proportionate for a Member State to impose exit taxes on the amount of unrealized gains recorded by a company at the moment of relocation without taking into account potential future decreases.

2. The taking into consideration of capital gains and losses realized after the transfer of the place of effective management of a company could disturb a balanced allocation of taxing rights.

3. The TFEU does not offer a guarantee to a company covered by the freedom of establishment that transferring its place of effective management to another Member State will be neutral as regards taxation due to disparities in the tax legislation of the Member States.
**Anti-Tax Avoidance Directive (ATAD)**
National Grid Indus (C-371/10)

- With respect to the proportionality of the exit tax at issue, the Court held that a distinction must be made between (a) the determination of the amount of the tax, and (b) the recovery of the tax.

**(b) the recovery of the tax**

Option either to:

(i) settle their exit tax liabilities immediately, i.e. at the time the company transfers its place of effective management to another Member State; or

(ii) defer payment of such taxes to the time when the capital gains are realized + interest on the deferred tax payment + the potential risk of non-recovery of the tax, which increases with time, might be taken into account by the Member States in their domestic rules on the recovery of deferred tax debts (**guarantee**).
Anti-Tax Avoidance Directive (ATAD)  
General Anti-Abuse Rule (GAAR)

**Aim:** tackle abusive tax practices not yet dealt with through specific provisions
Anti-Tax Avoidance Directive (ATAD)
General Anti-Abuse Rule (GAAR)

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
**Anti-Tax Avoidance Directive (ATAD)**

**General Anti-Abuse Rule (GAAR)**

ATAD’s GAAR is different from the other ATAD rules

- **No specific technical rules** the effect of which can be tested in the context of fundamental freedoms.
- It is rather the **individual situations** in which the GAAR is interpreted, invoked and applied domestically that warrant such an analysis.
  - The specific facts and circumstances need to be examined
  - Hallmarks are indicative
  - The establishment should not be **wholly artificial**
  - The freedoms arguably do not require additional objectives and pre-determined criteria
Anti-Tax Avoidance Directive (ATAD)
Controlled Foreign Company (CFC) rules

**Aim**: eradicate incentive of shifting income through re-attributing non-distributed income of low-taxed CFC to parent company

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**THE CLASSIC PROFIT SHIFT: Controlled Foreign Companies (CFC) Rules**

**BEFORE**

Companies are able to shift their profits to dependent companies in low-tax countries reducing, the taxable profits in the EU.

**AFTER**

With CFC Rules in place, companies can still shift their profits. But those profits will now be taxable in the EU.
Anti-Tax Avoidance Directive (ATAD)

Controlled Foreign Company (CFC) rules – CFC classification

When an entity or permanent establishment is considered a CFC?

1. The Member State of a taxpayer shall treat an entity, or a permanent establishment of which the profits are not subject to tax or are exempt from tax in that Member State, as a controlled foreign company where the following conditions are met:

(a) in the case of an entity, the taxpayer by itself, or together with its associated enterprises holds a direct or indirect participation of more than 50 percent of the voting rights, or owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of that entity; and

(b) the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment.
Anti-Tax Avoidance Directive (ATAD)
Controlled Foreign Company (CFC) rules – CFC income (approach A)

- **Determination** of the CFC income:
  
  ✓ Specified income from passive sources – approach A (categorical approach)
    
    • interest,
    • royalties,
    • dividends,
    • income from the disposal of shares,
    • income from financial leasing,
    • income from insurance, banking and other financial activities,
    • income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value.

This point shall not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.

Where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the preceding subparagraph.
Anti-Tax Avoidance Directive (ATAD)
Controlled Foreign Company (CFC) rules – CFC income (approach B)

• **Determination** of the CFC income:
  ✓ Income from ‘non-genuine’, tax-motivated arrangements – **approach B** (TP approach)

*For the purposes of this point, an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.*
Anti-Tax Avoidance Directive (ATAD)
Controlled Foreign Company (CFC) rules – available options

- Option to apply the CFC rules under approach A even if the CFC (resident in a third country) carries on a substantive economic activity (contrary to EU law - freedom of capital?)
- Option for non-application of the CFC rules (under approach B) to entities with accounting profits of no more than EUR 750,000, and non-trading income of no more than EUR 75,000; or (b) of which the accounting profits amount to no more than 10% of its operating costs for the tax period
- Option not to apply the CFC rules (under approach A) to an entity or PE if 1/3 or less of the income accruing to the entity or PE falls within the categories of income of approach A
- Option not to apply the CFC rules (under approach A) to financial undertakings if 1/3 or less of the entity's income from the categories of income of approach A comes from transactions with the taxpayer or its associated enterprises.
Anti-Tax Avoidance Directive (ATAD)
Controlled Foreign Company (CFC) rules – computation and taxation

● Computation of the CFC income

The income to be included in the tax base of the taxpayer shall be calculated in accordance with the rules of the corporate tax law of the Member State where the taxpayer is resident for tax purposes or situated.

The Member State of the taxpayer shall allow a deduction of the tax paid by the entity or permanent establishment from the tax liability of the taxpayer in its state of tax residence or location. The deduction shall be calculated in accordance with national law.
Anti-Tax Avoidance Directive (ATAD)
Cadbury Schweppes (C-196/04)

Cadbury Schweppes, a UK resident company the parent company of the Cadbury Schweppes group, indirectly owned two subsidiaries in Ireland, Cadbury Schweppes Treasury Services (CSTS) and Cadbury Schweppes Treasury International (CSTI).

CSTS and CSTI were established in the International Financial Services Centre (IFSC) in Dublin and were subject to tax at a rate of 10%.

Thus, they were subject to a “lower level of taxation” within the meaning of the UK legislation on Controlled Foreign Companies (CFC).
Anti-Tax Avoidance Directive (ATAD)  
Cadbury Schweppes (C-196/04)

The UK tax authorities took the view that, for the 1996 financial year, none of the exceptions from the application of the CFC rules applied to CSTS and CSTI, therefore they claimed corporation tax from one of the group companies resident in the UK on the profits made by the Irish subsidiaries (they applied the CFC rules).

Cadbury Schweppes appealed against that tax notice to the Special Commissioners of Income Tax, London. The Special Commissioners faced a series of uncertainties as to the application of EU law to the case, thus, they referred questions for preliminary ruling to the ECJ.
Anti-Tax Avoidance Directive (ATAD)  
Cadbury Schweppes (C-196/04)

- The CFC rules entail a disadvantageous treatment of resident companies having a subsidiary subject to a lower level of taxation in another EU Member State.

- **Restriction** on the freedom of establishment

- A restriction on the fundamental freedoms is permissible only if (i) it is justified by **overriding reasons of public interest**, (ii) it is appropriate to ensuring the attainment of the objective pursued and (iii) it does not go beyond what is necessary to attain the object (proportionality).

- **UK government**: prevention of tax avoidance

- **CJEU**:
  - The mere fact that a resident company establishes a subsidiary in another EU Member State could not give rise to a **general presumption of tax evasion**.
  - A national measure restricting the freedom of establishment with the purpose of preventing tax avoidance may only be justified if it specifically relates to **wholly artificial arrangements**.
**Anti-Tax Avoidance Directive (ATAD)**

Cadbury Schweppes (C-196/04)

- **wholly artificial arrangement:**

  The specific objective of a national measure restrictive on the freedom of establishment must be to prevent conduct involving the creation of wholly artificial arrangements that do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory.

- Subjective and objective element
  - Subjective element: objective to pay less tax
  - Objective element: creation of an entity which does not reflect economic reality
  - Case-by-case analysis
Anti-Tax Avoidance Directive (ATAD)
Cadbury Schweppes (C-196/04)

• A restriction on the fundamental freedoms is permissible only if (i) it is justified by overriding reasons of public interest, (ii) it is appropriate to ensuring the attainment of the objective pursued and (iii) it does not go beyond what is necessary to attain the object (proportionality).

• The CFC legislation must ensure that the CFC rules are not applied if the incorporation of a subsidiary reflects economic reality.

  ✓ In determining whether or not such an economic reality exists, objective circumstances must also be taken into account in addition to the subjective element consisting in the intention to obtain a tax advantage.

  ✓ These objective factors are, in particular, the extent to which the CFC physically exists in terms of premises, staff and equipment.

  ✓ The CFC rules are proportionate if they allow the resident company to produce evidence that the CFC is actually established and that its activities are genuine. When assessing the latter, objective factors must be taken into account.
Anti-Tax Avoidance Directive (ATAD)  
Cadbury Schweppes (C-196/04)

Synopsis

- The taxation of a resident parent company on the profits of a subsidiary resident in another Member State, where those profits are subject in the other Member State to a lower level of taxation than that applicable in the Member State of the parent, constitutes a restriction on the freedom of establishment unless applied only to wholly artificial arrangements intended to escape the normally due national tax.

- A wholly artificial arrangement does not exist where a subsidiary carries on genuine economic activities in the host Member State even where tax motives played a role in its establishment.

- The taxpayer must be given an opportunity to prove such genuine economic activity on the basis of objective factors (e.g. premises, staff and equipment of the subsidiary in its Member State of establishment).
Anti-Tax Avoidance Directive (ATAD)

Cadbury Schweppes (C-196/04)

ATAD’s GAAR

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

ATAD’s CFC rules (approach A)

This point shall not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.
Anti-Tax Avoidance Directive (ATAD)

Anti-hybrid rules

- ATAD I included very basic hybrid mismatch rules – only covered mismatches between Member States
- ATAD II expanded hybrid mismatch rules to include:
  - Hybrid mismatches involving non-Member States (if at least one party is a corporate taxpayer in a Member State)
  - Imported mismatches (deductible payment in a member state funds a deductible expenditure that gives rise to hybrid mismatch in another state)
  - Mismatches in treatment of PEs
  - Reverse hybrid entities (where effectively controlled by non-EU residents)
  - Tax residency mismatches
Anti-Tax Avoidance Directive (ATAD)

Anti-hybrid rules

● To the extent that a hybrid mismatch results in a **double deduction**:
  (a) the deduction shall be denied in the Member State that is the investor jurisdiction; and
  (b) where the deduction is not denied in the investor jurisdiction, the deduction shall be denied in the Member State that is the payer jurisdiction.

2. To the extent that a hybrid mismatch results in a **deduction without inclusion**:
  (a) the deduction shall be denied in the Member State that is the payer jurisdiction; and
  (b) where the deduction is not denied in the payer jurisdiction, the amount of the payment that would otherwise give rise to a mismatch outcome shall be included in income in the Member State that is the payee jurisdiction.