European Commission
Taxation And Customs Union Directorate General
SPA3 08/015,
B-1049 Brussels,
Belgium

11 September 2024

Dear Sir or Madam,

Response to European Commission Call for Evidence on the evaluation of the Anti-Tax Avoidance Directive (ATAD)

We are pleased to respond on behalf of the Deloitte[1] firms in Europe to the European Commission Call for Evidence on the Evaluation of Council Directive (EU) 2016/11641 of 12 July 2016, as amended by Council Directive (EU) 2017/9522 of 29 May 2017 (the Anti-tax Avoidance Directive (ATAD or the Directive)). We welcome the opportunity to input views on this topic. This letter sets out background context and comments in relation to this consultation.

1. General comments

EU legislation has and will continue to significantly curtail certain tax practices identified in the BEPS reports. This results notably from the combination of (a) the Anti-Tax Avoidance Directives (ATAD) which implemented the OECD BEPS in the EU and brought in anti-abuse measures (which all Member States should apply against common forms of "aggressive tax planning", since 1 January 2019[2]), and (b) various other sets of rules such as:

- The growing tax reporting/transparency obligations through the Directives on Administrative Cooperation to allow tax administrations in the EU to efficiently fight tax avoidance and effectively enforce ATAD I and ATAD II by obtaining relevant tax information at EU level, and gain access to the information they need to ensure that taxes are collected. DAC6 has notably introduced reporting obligations for a wide range of cross-border tax arrangements to enable tax authorities to react promptly against harmful tax practices and to amend their tax legislation accordingly. Tax reporting/transparency obligations continue to evolve through updates to the Directives on Administrative Cooperation (e.g., the latest DAC8 update on reporting obligations for crypto-asset service providers and potential other updates, especially regarding the exchange of information in relation to the Global Minimum Taxation).
- The AML IV and V Directives introduced beneficial ownership requirements.
- The changes arising from the implementation of the OECD's Pillar Two which will likely reduce possibilities of tax avoidance as they will ensure the liability of multinational groups for a minimum level of taxation. The Global Minimum Tax follows an objective that is in essence similar to the one of the ATAD, however going one step further combating tax avoidance and base erosion by imposing a minimum level of effective taxation of 15% on any income (derived either from normal profits or resulting from base erosion).

[1] For more information, see Deloitte.

[2] The Anti-Tax Avoidance Directives, the first of which entered into effect in 2019, contain anti-abuse measures, which all Member States should apply against common forms of "aggressive tax planning", notably providing tax administrations with consistent tools across the EU to tackle excess interest deductions, hybrid mismatches, controlled foreign companies (CFC) as well as other general anti-abuse measures. ATAD 3 addressing the misuse of shell companies within the EU is still in a draft format at this date.

- The use by the European Union of State aid and other infringement of EU law investigations to target tax fraud and tax avoidance with varying degrees of success.
- Case-law of the Court of Justice of the EU which addressed various issues related to tax fraud and tax avoidance, such as beneficial ownership, exit taxation, etc.
- National anti-tax avoidance measures introduced by certain EU Member States, which implemented more stringent rules than EU ones.

We note that the ATAD originally implemented the OECD BEPS Actions which dated from 2015, but the tax environment has significantly evolved since then under the effect of the above mentioned measures, creating an extremely rigid and complex set of rules imposing a heavy and costly administrative burden on taxpayers, for ATAD I, the calculations related to interest limitation are complicated. Taxpayers also experience significant tax risks due to the said complexity given the absence of coherence of the rules and of sufficient guidance and clarity on their application, limiting tax certainty.

We support a consistent approach to Member State implementation of Directives and would welcome EU wide guidance and/or a forum where interpretation or practical application could be discussed (similar to the EU Transfer Pricing Forum), which would help to improve legal certainty for taxpayers.

We would welcome a reflection to measure the efficiency of the ATAD in conjunction with other instruments mentioned above and thus effectively assess if these anti-tax avoidance measures are useful or not compared to the administrative burden imposed on taxpayers and intermediaries to ensure this is proportionate. The combination of the ATAD in conjunction with other pieces of legislation, such as the DACs, the OECD Multilateral Instrument, the EU Minimum Tax Directive (Pillar Two) and the defensive measures against non-cooperative jurisdictions, should be taken into account in any assessment of the effectiveness, efficiency and relevance of the ATAD, as well as its coherence with other policy initiatives and the added value of EU measures. In addition, the possible need for further legislation/regulation should be based on an impact assessment of existing and planned legislation.

The coherence of the ATAD with other EU legislation (i.e. such as the DAC, AML Directives, the case law from the European Court of Justice, etc.) could be improved. It is helpful to use similar, consistent definitions across different pieces of legislation (e.g. there is no definition of permanent establishment in ATAD while there are definitions in other directives such as PSD, associated enterprise is not the same in ATAD, PSD, Interest Royalty Directive and DAC6…).

The above mentioned measures have similar objectives, creating a certain overlap. In that context, the most debatable measure of the ATAD would be the controlled foreign company (CFC) rule as it aims to deter taxpayers from shifting profits to foreign low-taxed controlled entities or permanent establishments, which serves a similar purposes to Pillar Two. Following the same logic, the relevance of the whole ATAD in light of the Pillar Two rules could be questioned. We believe that there are opportunities to simplify the existing rules overall in order to declutter the EU tax system. This would strengthen the competitiveness of the Single Market, especially with the entry into force of the EU Directive ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

At the same time, considering that competitiveness will likely shape the political priorities of the 2024-2029 Commission, it would be necessary to focus on the reduction of tax obstacles and to well position the EU in global tax competition. As stated by professor Heckemeyer in July 2022 in a report requested by the European Parliament[3]:

"EU Member States have found it much easier to agree on curbing international tax planning than on reducing tax and administrative barriers in the Single Market. As a consequence, tax distortions in real investment decisions in the

[3] Heckemeyer, J. H., 2022, *Removal of taxation-based obstacles and distortions in the Single Market in order to encourage cross border investment*, publication for the Subcommittee on Tax Matters, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg.

Single Market have never decreased but increased over the past 20 years, the highly relevant barrier of an impossible cross border loss offset has not been resolved at all, whereas leeway for international tax planning has actually decreased, but at the cost of a complexity explosion."

"The EU must position itself in the global competition. The US tax policy has long been characterized by a greater awareness of the realities of international tax competition, providing also carrots and not only the stick for investors. In contrast, the EU stands out globally with a high-speed strategy that almost exclusively centers on the fight against tax avoidance. The Anti-Tax Avoidance Directive is representative for this endeavor: It is the first EU directive that does not bring any tax advantages for affected taxpayers, but only entails restrictions and costs."

"The EU's immediate focus should be on the reduction of actual tax obstacles in the Internal Market. Initiatives already launched by the EU and the OECD to reduce tax compliance costs for taxpayers are therefore to be welcomed and expanded.".

Similar comments have been made by Enrico Letta in his Report on the Future of the Single Market[4], that "*tax fragmentation remains a major barrier for EU businesses and SMEs in particular. A better alignment through a harmonised EU tax framework is key to facilitating the free movement of workers, goods and services and in supporting growth and private investment*."

2. Interactions of ATAD with the Global Minimum Taxation

The implementation of the OECD's Pillar Two rules in the EU through a Directive on minimum taxation[5] will likely reduce the possibility of tax avoidance as they will ensure the liability of multinational groups for a minimum level of taxation. Pillar Two indeed seeks to ensure large multinational enterprises pay a 15% effective tax rate, based on? the income inclusion and undertaxed profits rules. The Commission has also announced that Pillar Two information will be exchanged automatically among EU Member States through an additional update to the Directive on Administrative Cooperation – likely DAC9.

Pillar Two has the potential to allow for decluttering of the tax system as some anti-base-erosion and profit-shifting measures may not be necessary anymore in relation to taxpayers operating in a Pillar Two environment (but of course would be still necessary for situations and taxpayers not in the scope of Pillar Two), e.g. the hybrid mismatch rules, the foreign controlled companies (CFC) rules, and interest deduction limitation rules.

Pillar Two and the CFC rules both pursue the same objective, i.e. to prevent profit shifting to low-tax jurisdictions, and they overlap in their scope of application. In view of decluttering the tax system, the application of the CFC could be abolished for taxpayers operating in a Pillar Two environment. This would reduce compliance costs for taxpayers and would reduce the administrative burden for tax authorities. It would also reduce the complexity of EU and international tax law. CFC rules would still be necessary for situations and taxpayers not in the scope of Pillar Two. However, CFC rules could be amended to improve their alignment with the Pillar Two rules to limit complexity of the tax system and ease transition of taxpayers entering into the scope of Pillar Two.

Similarly, the relevance of the anti-hybrid mismatch rules under ATAD I and II might also be reduced for taxpayers operating in a Pillar Two environment. Similar comments as the ones detailed above in relation to the CFC are applicable with regards to the anti-hybrid mismatch rules under ATAD I and II.

[4] Enrico Letta's Report on the Future of the Single Market, 10 April 2024 < https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf >
[5] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, < https://eur-lex.europa.eu/eli/dir/2022/2523/oj >

3. Specific comments on the ATAD

3.1. Fragmentation originating from implementation options offered by the ATAD

The ATAD includes a large number of options for Member States in implementing the various measures into their domestic legislation. For example, with regard to the interest limitation rule provided in Article 4 ATAD, Member States may (among other things) choose to apply a de minimis threshold, an escape clause, an exception for standalone companies, and a group approach for taxpayer qualification. Similarly, several approaches are available to Member States under the ATAD when implementing the CFC rules. This includes providing a stricter definition of a CFC, the income on which a CFC charge can be imposed, and exemptions from the rules.

The ATAD measures are applicable to all taxpayers subject to corporate income tax in a Member State, including those operating in a Member State through a permanent establishment of an EU entity or of an entity resident of a third country. Likewise, the scope of the measures contained in the Directive introduced rules that have a significant impact on the configuration of Member States' corporate income tax. It can be questioned whether the Directive does not exceed the threshold for harmonisation of minimums based on the elimination of obstacles to the proper functioning of the Internal Market .

In addition, taking into account well-established CJEU case law that affirms that anti-abuse rules must be limited to what is strictly necessary, in those cases where there are currently options, the need for a harmonized provision is at least questionable. Although we are aware that ATAD includes a minimum standard, this standard must at the same time be the maximum as the anti-avoidance rules should be strictly limited, at least at the EEA level, to cases where there is a wholly artificial arrangement.

In this sense, we would suggest to remove the optional character of those provisions that allow for a more limited measure such as the group escape rule foreseen in the interest limitation provision as there shall not be situations of abuse within a consolidated group (I don't understand what's meant, that it's impossible for there to be situations of abuse of interest limits in consolidated groups? Maybe clarify the language).

3.2. Interest limitation rules

Adjustment of the interest limitation rules to the interest environment

The ATAD interest limitation rules limit the deductibility of taxpayers' exceeding borrowing costs to the higher of 30% of tax EBITDA (Earnings (taxable profits) before Interest, Tax, Impairments, Depreciation and Amortization) or EUR 3 million.

The BEPS Action 4 Report (§112 to 114) on Limiting Base Erosion Involving Interest Deductions and Other Financial Payment recognized that interest rates fluctuate over time, and that these ratios were set in a context of low interest rates (close to zero and even negative in certain cases) compared to historical averages at the time the Report was issued in 2015. It states that it is important for benchmark ratios to adapt to changing interest rate environments.

Given the economic context since 2022, the interest rate environment has changed across the globe with a significant interest rate increase due to monetary policies aimed at limiting inflation, making debt financing expensive. This is impacting negatively capital-intensive industries requiring large investments to carry out their activities (e.g. infrastructure developments and investments, real estate, automobile manufacturing, oil production and refining, steel production, telecommunications, and transportation sectors (e.g., railways and airlines)). These taxpayers are put at a disadvantage compared to other less capital-intensive sectors.

Accordingly, we call on the EU Commission to adjust the benchmark ratios to the changing interest rate environment by increasing these ratios to take into account interest rate growth.

We note that BEPS Action 4 on Limiting Base Erosion Involving Interest Deductions and Other Financial Payments foresees situations of interest rate volatility (see paragraphs 155 to 158), discussing best practices for linking net interest deductions to an entity's EBITDA, emphasizing how to manage earnings volatility that affects interest expense deductions. If an entity's interest expenses exceed the benchmark ratio due to earnings volatility, solutions like the group ratio rule or equity escape rule may be useful. These rules allow deduction of net interest expenses up to the group's ratio or based on an equity/total assets ratio, respectively. Additionally, Action 4 explores the use of average EBITDA over multiple years to mitigate the impact of short-term earnings volatility. This approach would balance lower earnings in one year with higher earnings in other years, reducing the immediate effects of a single year's downturn. Although more complex, averaging could protect against short-term volatility but not long-term instability or delayed EBITDA realization from investments. Overall, the use of average EBITDA could address volatility. Paragraph 25 of Action 4 adds that in calculating the group's ratio, a country may apply an uplift of up to 10% to the group's net third-party interest expense. This means only net interest expense that takes an entity's net interest/EBITDA ratio above the higher of the benchmark fixed ratio and the group's ratio is disallowed. We note that the ATAD has not implemented these two mechanisms which may prove useful in the current context of high interest rates. We thus call on the Commission to consider the introduction of these two options.

EBITAD Tax Concept

The ATAD interest limitation rules use an EBITDA tax concept – different from the accounting one – which excludes exempt income such as dividends. This negatively impacts headquarter entities and jurisdictions mainly receiving this types of income, thus limiting their ability to deduct interest paid to finance their operations.

From an economic point of view, the exclusion of exempt income does not seem justified. Indeed, the interest limitation rule tries to establish a limit to what, reasonably, an entity should assume as debt based on its ability to generate income, which has nothing to do with whether the income received by the entity is exempt or not.

Member States apply, as permitted by the Parent-Subsidiary Directive, two methods to eliminate double taxation, the exemption and the credit method. In cases where the dividend is exempt, the dividend will be excluded from the EBITDA under the exemption method, which on the one hand does not make any sense from an economic point of view, and on the other hand treats these entities worse than those that apply the credit method that would include the dividend in the EBITDA for the purposes of calculating the deductible amount.

Group escape clause

The ATAD offered the option to Member States to introduce a group escape clause in line with article 4(5), under (a) or (b). However, almost half of the Member States have not taken this option. As anti-avoidance rules shall be limited to those cases where there is a possible abusive situation, we call on the Commission to consider if this group escape clause should be imposed to all Member States, instead of being optional. In addition, imposing the escape rule would simplify the rules and improve the coherence and the competitiveness of the Single Market.

Exclusion of loans used to fund a long-term public infrastructure project as described in article 4(4)(b) of the ATAD

The ATAD offers the option to Member States to allow the exclusion of loans used to fund a long-term public infrastructure project as described in article 4(4)(b) of the ATAD. Not all Member States have implemented this exclusion. Similarly to the group escape clause, this exclusion should not be an option, but should be mandatory for all Member States in order to simplify the rules and improve the coherence and the competitiveness of the Single Market. This would be relevant especially for projects related to digital transformation and sustainable transition, which projects usually require significant amounts of financing and this implies greater amounts of interest to be paid. Besides that, borrowings by social housing corporations for the purpose of building, renovating and modernizing social housing projects should be considered to be in scope of long-term public infrastructure projects, i.e. as part of the social infrastructure. The absence of such an exclusion could to some extent be assimilated to a discrimination as certain economic activities require more financing compared to others.

Carry forward of exceeding borrowing costs

The interest limitation rule may lead in certain situations to double taxation. It allows a carry forward of exceeding borrowing costs which cannot be deducted, but there might be situations where a taxpayer is in the impossibility of recovering exceeding borrowing costs. The ATAD does not provide practical solution to taxpayers to allow for a full deduction, notably in specific situations such as the case of liquidations. We would welcome reflection on the ability to deduct 100% of exceeding borrowing costs in certain situations, and on the possibility to take the deduction at some point due to the specific facts of the taxpayer (notably due to low profitability).

Complexity of the calculations

As mentioned above, the calculations related to interest limitation are complicated, this is imposing a heavy and costly administrative burden on taxpayers, as well as creating significant tax risks.

3.3. GAAR

The ATAD introduced a General Anti-Abuse Rule (GAAR) targeting arrangements which defeat the object of applicable tax, are not genuine and are not put in place for valid commercial reasons which reflect reality. At the same time, the Parent-Subsidiary Directive (PSD) was amended to include a GAAR, while the Interest and Royalty Directive also contains one. These three GAARs have the same purpose. This is creating an overlap and unnecessary complexity, while only one GAAR would suffice. We would thus call on the Commission to consider only keeping one GAAR generally applying to all situations, transactions or tax arrangements.

In addition, article 6(3) of the ATAD reads that "*Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law*." No further guidance is provided beyond the reference to a calculation in accordance with national law. It would, however, be useful to clarify that such taxation calculated in accordance with national law should be based on the economic reality of the arrangements and transactions considered.

3.4. CFC

The CFC rules in the ATAD aim to discourage multinational companies from shifting profits from their parent company in a high tax country to controlled subsidiaries in low or no tax countries to reduce the group's tax liability. The CFC rule will allow the EU Member State where the parent company is located to tax certain profits that the company shifts to a country that imposes low or no tax. The CFC rules under ATAD were addressing the risk of under-taxation of profits. Now that the EU has adopted the Directive ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, the issue of under-taxation of profits and income is more broadly coordinated and tackled, going one step further by imposing a 15% minimum effective tax rate in all jurisdictions where a multinational enterprise group (MNE) is present. There is thus room for simplification, at least for MNEs falling in the scope of Pillar Two, by only imposing the latter set of rules and abolishing the ATAD CFC for companies in scope of the Pillar Two rules for the sake of proportionality. For other taxpayers, we would recommend to improve the convergence of the CFC ATAD with the Pillar Two rules to simplify compliance, especially in case of transition in or out of the scope of Pillar Two, as well as to simplify administration of the rules.

In similar terms, the Qualified Domestic Minimum Top-up tax (QDMTT) may generate double taxation as the same income may be taxed under CFC rules and under the QDMTT in the country of residence of the subsidiary.

CFC rules, especially Article 7(2) are applied to holding companies, while holding activities, if carried out with sufficient and appropriate material and human resources to perform the holding activities should be considered as genuine economic activities. The concept of economic activity applied by the CJEU in analysing the freedom of establishment (e.g. in Eqiom – Case C-6/16) confirms this as it includes passive economic activities or purely investment activities, provided that the foreign entity's activity is actual and does not constitute a fictitious or wholly artificial arrangement. Accordingly, in order to limit the Directive to cases where there is an abuse and to be compliant with the principles of EU law and of the CJEU jurisprudence, we would welcome a clarification that the CFC rules should not apply to holding companies carrying out genuine economic activities.

3.5. Exit tax

Article 5 of the ATAD has introduced an exit tax to prevent companies from leaving a jurisdiction for the sole purpose of avoiding taxation. The exit tax under the ATAD applies to any exiting entity, regardless of the reason of the exit, and is levied on the unrealized capital gain generated at the time of the exit. Article 5 of the ATAD grants taxpayers the right to defer payment by paying the exit tax in instalments over a period of maximum five years (subject to the condition that the new jurisdiction is either another Member State or an EEA country with which the Departure Member State or the EU concluded an agreement on the mutual assistance for the recovery of tax claims).

The exit tax under the ATAD may be against the economic capacity of taxpayers as the assets from which the unrealised capital gains are derived will not necessarily be disposed of within the 5 years set by the ATAD, i.e. the capital gains will not be effectively realised and thus would impose to the taxpayer to find financing (or available cash) to have the capacity to pay the exit tax. We would welcome the implementation of alternative options to be applied by all Member States to effectively retain taxation rights, such as the constitution of a guarantee with the Member State of exit until the date of effective realisation of the assets.

Disputes between two Member States may appear in relation to exit taxation at the time of the transfer of an entity from one Member State to another. It is not clear in such situation if there is any possibility to solve this issue as exit taxation is not a double taxation in the sense of EU law and treaties. Mutual Agreement Procedures are only available to solve transfer pricing or matters on the interpretation or application of the double tax agreements. We would thus welcome any clarification on how to solve issues related to exit tax disputes (e.g. dispute resolution mechanism or arbitration mechanism).

3.6. Hybrid arrangements

Hybrid arrangements are tackled by ATAD I and ATAD II, as well as by the PSD and by Pillar Two. We would welcome further coherence between all these sets of rules to apply same concepts similarly and limit complexity. Beyond, we would call on the Commission to consider simplifying anti-hybrid rules at EU level to only keep one set of rules. Please also refer to our above comments in relation to interactions of ATAD with Pillar Two.

We note that, especially in relation to ATAD II, the burden of proof to demonstrate the absence of hybrid arrangement is placed on the taxpayer, even though information on the tax regime applicable to the beneficiary is not always available. This is a source of complexity and heavy administrative cost for taxpayers. In any case, the tax authorities of the Member States are supposed to already have this information through reporting and automatic exchange of information under DAC6 (except for financing arrangements set up before DAC6 came into force).

Certain concepts related to hybrid arrangements lack clarity, such as the concept of “acting together”, a concept to be applied when determining if a specific situation involves “associated enterprises” which is one of the conditions required for being in the scope of the anti-hybrid rules. This concept is included in final report on Action 2 and was then incorporated into the anti-hybrid mismatch rules under ATAD II without being defined. We would thus welcome clarification and guidance at EU level on the concept of “acting together” that is consistently and coherently applied among EU Member States in view of strengthening predictability and tax certainty for taxpayers.

We would be happy to discuss any comments or questions you may have regarding our responses. We can be reached as follows: pzalba@deloitte.com or rpozacid@deloitte.es.

Yours sincerely,

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