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The European Commission's new proposals against anti-tax avoidance and aggressive tax planning

Luxembourg tax alert

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On 28 January 2016, the European Commission presented an anti-avoidance package in the current context of the implementation of BEPS measures. Here we have concentrated on two aspects of this package, the anti-avoidance proposal as well as the automatic exchange for Country-by-Country reporting between European Member States.

European Commission's anti-avoidance proposal

On the basis of the proposition, the measures would apply to all taxpayers that are subject to Corporate tax in one or more European Member State(s), including permanent establishments in one or more European Member State(s) of entities resident for tax purposes in a third country.

Following the proposition, *"national corporate tax systems are disparate and independent action by Member States would only replicate the existing fragmentation of the internal market in direct taxation […] this directive only aims to achieve the essential minimum degree of coordination within the Union […] each Member States could still be able to apply internal measures or double tax treaties aimed at safeguarding a higher level of protection for domestic corporate tax bases"*.

The draft anti-tax avoidance directive covers rules in the following areas.

- **Interest limitation rule under conditions**. Borrowing costs would always be deducted to the extent that the taxpayer received interest or other taxable revenues from financial assets as defined in the proposition. Where interest costs exceed interest revenues and equivalent revenues, a deduction limitation would apply. The interest would be deductible up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation for a given tax year, or up to an amount of EUR 1 million, whichever is higher (with exceptions such as a group-wide test).
- **Cross-border transfer of assets or residence taxation (exit tax)** whereby a taxpayer would be subject to tax for an amount equal to the fair market value of the transferred assets, at the time of exit, less their value for tax purposes subject to four circumstances.
  The draft directive also provides for the deferral of payment of the above mentioned exit tax by paying in instalments over a 5 year period provided the assets / residence of a taxpayer's head office / permanent establishment are transferred to another European Member State or a third country that is party to the EEA Agreement.
- **Switch-over clause** whereby European Member States would not exempt a taxpayer from tax on foreign income which the taxpayer had received either as a profit distribution from or the disposal of shares in an entity, or as income from a permanent establishment in a third

country. The income would be taxable (but possibility to apply a tax credit) where the corporate tax rate in the third country is lower than 40% of the statutory tax rate that would have been charged under the applicable corporate tax system in the European Member State of the taxpayer.

- **General anti-abuse rule** whereby non-genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions shall be ignored for the purposes of calculating the corporate tax liability. The tax liability would in such a case be calculated by reference to economic substance.
- **Controlled foreign company income rules** whereby the tax base of a taxpayer would include the non-distributed income of an entity provided certain conditions are met.
- **Hybrid mismatches rules** whereby two European Member States would give a different legal characterisation to the same taxpayer / instrument as well as its permanent establishments in one or more European Member State(s). Here, the legal characterisation of the taxpayer / instrument in the source country would be followed by other European Member State(s). It should be noted that the proposed rule is not in line with the OECD BEPS action 2 recommendation.

The above-mentioned measures have not yet been accepted by the European Member States. A unanimous agreement of all European Member States is required in order for the measures to be transposed into their respective national laws. It is as yet unclear how long this process will take. Considering the complexity of the many technical tax issues, it is possible that some time may be required before all European Member States can reach an agreement.

Moreover, if the European Member States succeed in reaching an agreement, they could transpose the measures into their respective national laws by different means (as it is only a minimal degree of coordination) and could also have different views on the ways to interpret the various measures. We are therefore not sure whether the objective of this proposal, which is to avoid a fragmentation of the internal market in direct taxation, can be reached.

European Commission proposal on the automatic exchange for Country-by-Country reporting between European Member States

The European Commission has also published a revised administrative cooperation directive proposal to allow for the automatic exchange of country-by-country (CbC) reports.

On 27 January 2016 Luxembourg signed, along with 30 other countries (including many European countries), the OECD multilateral agreement for the automatic exchange of CbC reports (BEPS action 13 on transfer pricing reporting standards). The first exchanges will start in 2017-2018 and will concern information dating as from year 2016. The CbC report will, among others, aggregate information annually relating to the global allocation of income and tax paid within a group (with an annual consolidated group revenue equal to or exceeding €750M).

The European proposal for the automatic exchange of CbC reporting between European Member States requires such countries to exchange the CbC reports automatically subject to certain conditions. The European Member States will now have to reach an agreement on this proposal in order for it to be transposed in their respective national laws and become applicable.

Please find the **Deloitte European Tax Alert**, with more details on both measures. We will keep you updated with any developments in this respect.

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