Corporate taxation: common system of taxation applicable to interest and royalty payments. Recast

2011/0314(CNS) - 11/11/2011 - Legislative proposal

PURPOSE: recasting of Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

PROPOSED ACT: Council Directive.

BACKGROUND: the problems addressed by the Directive arise from the existence of particular corporate tax obstacles to the functioning of the internal market: **cross-border interest and royalty payments are subject to heavier taxation than domestic transactions**. In the case of purely domestic operations, the recipient of the payment is subject to corporate tax as a resident taxpayer in the Member State where it is resident for tax purposes. In case of international payments, they may be also subject to withholding taxes in the source Member State.

The main cause of economic distortions, compliance costs and the risk of excessive or double taxation is the existence of taxes levied at source; also, the disparities in taxation of the different types of cross-border capital flows distort business behaviour. The amendments proposed in this recast aim to extend the Directive's scope and apply the tax exemption in a wider number of cases.

The Commission and international tax stakeholders have always been convinced of the need for an EU instrument in this area, as neither unilateral measures taken by Member States nor bilateral tax agreements have provided a satisfactory solution that fully meets the requirements of the internal market. In its Communication entitled 'A package to tackle harmful tax competition in the European Union', the Commission stressed the need for coordinated action at European level to tackle harmful tax competition. In April 2009, the Commission presented a report on the application of Directive 2003/49/EC. It indicates that overall implementation of the Directive has been satisfactory and refers to possible amendments in order to extend its coverage.

IMPACT ASSESSMENT: the Commission's impact assessment referred to the problems deriving from withholding taxes on cross-border interest and royalty payments: economic distortions in business behaviour; compliance costs due to paperwork and delays in making tax relief effective; and the risk of double taxation.

While not taking any policy action was rejected, a number of options were examined:

1) Extending the Directive's benefits to all payments between unrelated undertakings: under this option, the different taxation of dividends, interest and royalties would continue so that the corresponding economic distortions would remain. It it would also involve steeper reductions in Member States' tax revenues.

2) Aligning the Directive's requirements with those of the Parent-Subsidiary Directive on dividend taxation. This is the option chosen by this recast since it offers a more balanced result: it is more effective in reducing economic distortions and does not diminish Member States' tax revenue as much as the previous option:

-

- concerning **interest payments**, the loss should not exceed EUR 200 to EUR 300 million and would affect the 13 EU Member States that still apply withholding taxes to outgoing interest payments – Belgium, Bulgaria, the Czech Republic, Greece, Hungary, Ireland, Italy, Latvia, Poland, Portugal, Romania, Slovenia and United Kingdom -;
- concerning **royalty payments**, the loss should not exceed EUR 100 to EUR 200 million and would affect the seven countries with the largest negative royalty balances as a share of GDP - Bulgaria, the Czech Republic, Greece, Poland, Portugal, Romania and Slovakia.

According to the impact assessment, the initiatives contained in this recast proposal to eliminate withholding taxes in a larger number of cases would entail compliance cost savings estimated at between **EUR 38,4 and EUR 58,8 million**.

LEGAL BASIS: Article 115 of the Treaty on the Functioning of the European Union (TFEU).

CONTENT: the aim of this recast is to resolve some of the problems resulting from the limited scope of Directive 2003/49/EC. There are cross-border payments outside its scope that face withholding taxes at source. The purpose of the Directive is to **put cross-border interest and royalty payments on an equal footing with domestic payments**, by eliminating juridical double taxation, burdensome administrative formalities and cash-flow problems for the companies concerned. It is therefore proposed:

- to **extend the list of companies** to which the Directive applies and to reduce the shareholding requirements to be met for companies to qualify as associated;
- to **add a new requirement for the tax exemption:** the recipient has to be subject to corporate tax in the Member State of its establishment on the income derived from the interest or royalty payment. This condition seeks to ensure that the tax relief is not granted when the corresponding income is not subject to tax and thus close a loophole that could be used by tax evaders;
- lastly, a **technical amendment** is proposed to avoid situations where payments made by a permanent establishment and deriving from its activities are denied the exemption on the grounds that they do not constitute a tax-deductible expense.

BUDGETARY IMPACT: the proposal has no impact on the EU’s budget.