

# Common system of taxation applicable in the case of parent companies and subsidiaries of different Member States: tackling double non-taxation

2013/0400(CNS) - 25/11/2013 - Legislative proposal

**PURPOSE:** to prevent fraud and tax evasion through artificial arrangements and thus fight against corporate base erosion.

**PROPOSED ACT:** Council Directive.

**ROLE OF THE EUROPEAN PARLIAMENT:** the Council adopts the act after consulting the European Parliament but without being obliged to follow its opinion.

**BACKGROUND:** Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (PSD) exempts dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and eliminates double taxation of such income at the level of the parent company.

The Commission considers, however, that the benefits of [Directive 2011/96/EU](#) should not lead to situations of double non-taxation and, therefore, generate unintended tax benefits for groups of parent companies and subsidiaries of different Member States in comparison with groups of companies of the same Member State.

**Double non-taxation resulting from hybrid financial instruments deprives Member States of significant revenues** and creates unfair competition between businesses in the Single Market.

**Hybrid loan arrangements** are financial instruments that have characteristics of both debt and equity. Due to different tax qualifications given by Member States to hybrid loans, payments under a cross border hybrid loan are treated as a tax deductible expense in one Member State (the Member State of the payer) and as a tax exempt distribution of profits in the other Member State (the Member State of the payee), thus resulting in an unintended double non-taxation.

To solve the issue, the **Code of Conduct Group** agreed guidance, which cannot be safely implemented under Directive 2011/96. However, double non-taxation is one of the key areas for urgent and coordinated action to be taken in the EU:

- [The Action Plan to strengthen the fight against tax fraud and tax evasion](#) adopted by the Commission on 6 December 2012 identifies tackling mismatches between tax systems as one of the actions to be undertaken in the short term (in 2013). It also announced a review of anti-abuse provisions in the corporate tax directives, including PSD, with a view to implement the principles underlying its [Recommendation on aggressive tax planning](#).

In a [resolution adopted on 21 May 2013](#), the European Parliament called on the Commission to: (i) address the problem of hybrid mismatches between the different tax systems used in the Member States; (ii) present in 2013 a proposal for the revision of the PSD with a view to revise the anti-abuse clause and to eliminate double non-taxation in the EU as facilitated by hybrid arrangements.

**IMPACT ASSESSMENT:** the impact assessment found that counteracting double non-taxation deriving from hybrid financial arrangements and aggressive tax planning will have a positive impact on the tax revenue of Member States.

With regard to hybrid loan mismatches, the impact assessment found that the best option is to **deny the tax exemption in the PSD to profit distribution payments that are deductible in the source Member State.**

The assessment also found that the most effective option would be to **update the current anti-abuse provisions of the PSD** and make it obligatory for Member States to adopt the common anti-abuse rule.

**CONTENT:** the proposal seeks to tackle hybrid financial mismatches within the scope of application of Directive 2011/96/EU (PSD) and to **replace the current anti-abuse provisions with a general anti-abuse rule**, based on the similar clause included in the Recommendation on aggressive tax planning.

To counteract double non-taxation deriving from mismatches in the tax treatment of profit distributions between Member States, the Member State of the parent company and the Member State of its permanent establishment **should not allow those companies to benefit from the tax exemption applied to received distributed profits**, to the extent that such profits are deductible by the subsidiary of the parent company.