

Rules against tax avoidance practices that directly affect the functioning of the internal market

2016/0011(CNS) - 28/01/2016 - Legislative proposal

PURPOSE: to establish rules against tax avoidance practices that directly affect the functioning of the internal market.

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: the European Council Conclusions of 18 December 2014 cite "an urgent need to advance efforts in the fight against tax avoidance and aggressive tax planning, both at the global and European Union levels".

The proposed Directive is **one of the constituent parts of the Commission's Anti- Tax Avoidance Package**. It builds on the [Action Plan for Fair and Efficient Corporate Taxation](#), presented by the Commission on 17 June 2015 and it responds to the finalisation of the project against Base Erosion and Profit Shifting (BEPS) by the G20 and the **Organisation for Economic Cooperation and Development (OECD)**. It also responds to demands from the European Parliament, several Member States, businesses and civil society, and certain international partners for a stronger and more coherent EU approach against corporate tax abuse.

The current political priorities in international taxation highlight the need for ensuring that tax is paid where profits and value are generated. **The schemes targeted by this proposed Directive** involve situations where taxpayers act against the actual purpose of the law, taking advantage of disparities between national tax systems, to reduce their tax bill.

Taxpayers may benefit from low tax rates or double deductions or ensure that their income remains untaxed by making it deductible in one jurisdiction whilst this is not included in the tax base across the border either. The outcome of **such situations distorts business decisions in the internal market** and unless it is effectively tackled, could create an environment of unfair tax competition.

IMPACT ASSESSMENT: no impact assessment was carried out for this proposal given that the proposed Directive is complementary to other initiatives aimed to implement the output of the OECD BEPS reports in the EU and contribute towards a common minimum level of protection against tax avoidance.

To provide up-to-date analysis and evidence, a **separate Staff Working Document** accompanying the draft Directive gives an extensive overview of existing academic work and economic evidence in the field of base erosion and profit shifting.

CONTENT: the draft Directive is **broadly inclusive** and aims to capture all taxpayers which are subject to corporate tax in a Member State. Its scope also embraces permanent establishments, situated in the Union, of corporate taxpayers which are not themselves subject to the Directive.

Having the aim of combating tax avoidance practices which directly affect the functioning of the internal market, the proposal lays down anti- tax avoidance rules in **six specific fields**:

1. **The deductibility of interest:** multinational groups often finance group entities in high-tax jurisdictions through debt and arrange that these companies pay back 'inflated' interest to subsidiaries resident in low-tax jurisdictions. The aim of the proposed rule is to discourage the above practice by limiting the amount of interest that the taxpayer is entitled to deduct in a tax year. Given that this Directive fixes a minimum level of protection for the internal market, it is envisaged setting the rate for deductibility at the top of the scale (10 to 30%) recommended by the OECD. Member States may then introduce stricter rules.
2. **Exit taxation:** taxpayers may try to reduce their tax bill by moving their tax residence and/or assets to a low-tax jurisdiction. Exit taxation serves the purpose of preventing tax base erosion in the State of origin when assets which incorporate unrealised underlying gains are transferred, without a change of ownership, out of the taxing jurisdiction of that State. The proposal also addresses the EU law angle of exit taxation by giving taxpayers the option for deferring the payment of the amount of tax over a certain number of years and settling through staggered payments.
3. **A switch-over clause:** given the inherent difficulties in giving credit relief for taxes paid abroad, States tend to increasingly exempt foreign income from taxation. Switch-over clauses are commonly used against such practices. Namely, the taxpayer is subjected to taxation (instead of being exempt) and given a credit for tax paid abroad. In this way, companies are discouraged from shifting profits out of high-tax jurisdictions towards low-tax territories, unless there is sufficient business justification for these transfers.
4. **A general anti-abuse rule:** such a rule is designed to cover gaps that may exist in a country's specific anti-abuse rules against tax avoidance. It would allow authorities the power to deny taxpayers the benefit of abusive tax arrangements. Within the Union, the application of anti-abuse rules should be limited to arrangements that are 'wholly artificial' (non-genuine); otherwise, the taxpayer should have the right to choose the most tax efficient structure for its commercial affairs.
5. **Controlled foreign company (CFC) rules:** taxpayers with controlled subsidiaries in low-tax jurisdictions may engage in tax planning practices whereby they shift large amounts of profits out of the (highly-taxed) parent company towards subsidiaries which are subject to low taxation. The effect is to reduce the overall tax liability of the group. CFC rules re-attribute the income of a low-taxed controlled foreign subsidiary to its parent company. As a result of this, the parent company is charged to tax on this income in its State of residence – usually, this is a high-tax State.
6. **A framework to tackle hybrid mismatches:** these mismatches are the consequence of differences in the legal characterisation of payments (financial instruments) or entities when two legal systems interact. Such mismatches may often lead to double deductions (i.e. deduction on both sides of the border) or a deduction of the income on one side of the border without its inclusion on the other side. In order to ensure that Member States introduce rules to effectively combat against these mismatches, this Directive prescribes that the legal characterisation given to a hybrid instrument or entity by the Member State where a payment, expense or loss, as the case may be, originates shall be followed by the other Member State which is involved in the mismatch.