*Taxation*
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# Tax Developments in the European Union

## ***1. EU Anti - Tax Avoidance Directive - Implementation***

*We would like to bring to your attention that following the adoption of the "Anti - Tax Avoidance Directive" by the European Council on 12 July 2016, certain measures are to be incorporated in the national legislation of each Member State . The Directive builds on recommendations under the Base Erosion and Profit Shifting (BEPS) project and extends these further with the aim to combat tax avoidance practices.*

*The Directive lays down anti - tax avoidance rules in the below fields:*

1. *Deductibility of interest*
2. *Exit taxation*
3. *A general anti-abuse rule*
4. *Controlled foreign company (CFC) rules*
5. *A framework to tackle hybrid mismatches*

*Member States will have until 31/12/2018 to transpose the Directive into their national laws, except for the exit taxation rules, for which they will have until 31/12/2019.*

***Interest limitation rule***

*The aim of the proposed rule is to discourage multinational groups from artificially shifting their debts to group companies in high-tax jurisdictions and paying back "inflated" interest to group companies resident in low-tax jurisdictions. For this purpose, the Directive sets the below rules:*

- *Exceeding borrowing costs (being the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest and economically equivalent taxable revenues) shall be deductible in the year in which they are incurred only up to 30% of EBITDA*
- *Member States are given the discretion to grant taxpayers the right to deduct exceeding borrowing costs up to Euro 3.000.000 (for the entire group) or to fully deduct exceeding borrowing costs if the taxpayer is a standalone entity*
- *There is no distinction as to the origin of the loans i.e. it covers loans granted locally, cross border, with 3rd countries, 3rd parties, associated parties or intragroup*

***Exit Taxation***

*Exit taxation serves the purpose of preventing tax base erosion in the State of origin when assets which incorporate unrealized underlying gains are transferred, without a change of ownership, out of the taxing jurisdiction of that State. For this purpose, a taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets, at the time of exit, less their value for tax purposes, in any of the following cases:*

1. *A taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country in so far as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer*
2. *A taxpayer transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or in a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer*
3. *A taxpayer transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State*

4. *A taxpayer transfers the business carried on by its permanent establishment from a Member State to another Member State or to a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer*

***General anti-abuse rule***

*For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances.*

*An arrangement or series of arrangements shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.*

***Controlled foreign company (CFC) rules***

*The Member State of a taxpayer shall treat an entity or a permanent establishment of which the profits are not subject to tax or are exempt from tax in that Member State as a CFC where the following conditions are met:*

1. *In the case of an entity, the taxpayer by itself, or together with its associated enterprises, holds a direct or indirect participation of more than 50% of the voting rights, or owns directly or indirectly more than 50% of capital or is entitled to receive more than 50% of the profits of that entity; and*
2. *The actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid by the entity or permanent establishment.*

*Where an entity or permanent establishment is treated as a CFC, the Member State of the taxpayer shall include in the tax base of the taxpayer:*

*(a) The non-distributed income of the CFC from the below sources:*

- *Interest or any other income generated by financial assets*
- *Royalties or any other income generated from intellectual property*
- *Dividends and income from the disposal of shares*
- *Income from financial leasing*
- *Income from insurance, banking and other financial activities*
- *Income from invoicing companies earning sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value*

*The above shall not apply where the CFC carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.*

*(b) The non-distributed income of the CFC derived from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage*

***Hybrid mismatches***

*Hybrid mismatches are the consequence of differences in the legal characterisation of payments or entities in different jurisdictions which may lead to deductions in both jurisdictions or a deduction of the income in one jurisdiction without its inclusion in the other jurisdiction.*

*In case a hybrid mismatch results to a double deduction, the deduction shall be granted only in the Member State where the payment has its source. In case a hybrid mismatch results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment.*

*It should be noted that the provisions of the Directive constitute a minimum standard, with Member States having the freedom to implement the measures in a stricter manner.*

## ***2. Extension to the EU Council Directive 2011/16/EU on administrative cooperation in the field of taxation to Country - by Country - Reporting (CbC)***

*On 25 May 2016, the European Union's Economic and Financial Affairs Council (ECOFIN) voted the implementation of CbC reporting rules for Multinational Enterprises (MNEs) operating in the European Union with consolidated revenue equal to or greater than Euro 750 million in the preceding year*

*Member states will have to adopt CbC reporting legislation for fiscal years from 1 January 2016 onwards. For MNEs with a non EU parent company that does not file a CbC report in its country, an option will be granted for the reporting to be introduced as of 1 January 2017 and filing to be performed via an EU surrogate parent company.*

*The first report will have to be filed by the MNE within 12 months from the end of the fiscal year. Member States will then exchange them within 3 months thereafter (i.e. 15 months from end of fiscal year). For the first exchange by Member states, this period is extended to 18 months instead of 15*

*Companies operating in the European Union should review their structures and be pro-active in assessing how the above changes can affect their operations.*

*We would be pleased to discuss further with you and assist you in obtaining a more detailed insight as to how the above changes can affect your business.*

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