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COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States

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1. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

EU Context

Hybrid loan mismatches

As part of its work on the distorting effects of mismatches the Code of Conduct Group reviewed a hybrid form of debt between associated companies called profit participating loans ("PPLs"). The issue was that payments under a cross-border PPL were treated as tax deductible in the source MS and as a tax exempt distribution of profit (dividend) in the recipient MS resulting in double non-taxation.

In May 2010 the Code Group agreed that the recipient MS should follow the tax treatment (i.e. as debt or equity) given to hybrid loan payments by the source MS in order avoid double non-taxation (doc. 10033/10 FISC 47).

However in October 2011, a Commission analysis showed that this agreed solution clashed with the Parent Subsidiary Directive¹ ("PSD"). There were two alternatives to address this: (i) develop an alternative solution in the Code Group or (ii) amend the PSD. A meeting of MS experts in a Commission working group concluded that a targeted amendment of the PSD would be preferable to MS.

The Action Plan to strengthen the fight against tax fraud and tax evasion adopted by the Commission of 6 December 2012 (COM (2012)722) included this amendment as an action to be undertaken in the short term (2013). As a follow-up to the Action Plan, the Commission held two consultation meetings for MS experts and external stakeholders from the private sector, academia, business organisations, tax associations in April 2013 to discuss two policy options.

Under option A1 profit distribution payments deductible in the source MS would be excluded from the PSD. Under option A2 the tax exemption benefits in the PSD would be denied to profit distribution payments deductible in the source MS.

Eight out of the fifteen MS who participated strongly supported option A2. One MS accepted amending the PSD for clarity with a slight preference for this option. Four MS said that they would accept an amendment for clarification purposes, even though they believed that no amendment to the PSD was necessary. One MS was in favour of option A1. Another MS was open to both options and urged a quick amendment. Four MS chose not to attend.

¹ Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast), as amended by Council Directive 2013/13/EU adapting certain directives in the fields of taxation by reason of the accession of the Republic of Croatia.

At the Stakeholders' meeting, the views expressed were different. Although responses to the 2012 public consultation had agreed in general that such mismatches were undesirable, some business representatives did not see double non-taxation as negatively. In particular option A2 was disliked as limiting the rights of taxpayers and MS; allowing double non-taxation was considered to be a possibly deliberate choice on the part of MS. Other business representatives supported option A1. Conversely, NGOs and academics in general supported option A2.

On 21 May 2013, the European Parliament adopted a resolution² urging MS to embrace the Commission's Action Plan and fully implement the Recommendation on aggressive tax planning. The European Parliament also called on the Commission to address mismatches between different tax systems and present a proposal for the revision of the PSD to revise the anti-abuse clause and to eliminate double non-taxation in the EU.

In its conclusions of 22 May 2013, the European Council called for rapid progress on certain tax issues and announced that "the Commission intends to present a proposal before the end of the year for the revision of the 'parent/subsidiary' Directive".³

Anti-abuse provision

The Action Plan also commits the Commission to review the anti-abuse provisions of the PSD and the Directives on Interest and Royalties and Mergers with a view to implementing the principles underlying the Recommendation on aggressive tax planning.

The Recommendation proposed that MS should adopt a General Anti-Abuse Rule ("GAAR") to counteract aggressive tax planning which fall outside the scope of existing specific anti-avoidance rules. However the Recommendation does not apply to the corporate tax directives so its underlying principles cannot be relied upon in without legislative action.

The GAAR proposal follows the approach taken in article 13 of the proposed Directive implementing enhanced cooperation in the area of the financial transaction tax ("FTT").⁴ Consultations with MS and stakeholders were held in April 2013.

Four of the five MS who took the floor argued that a GAAR should not be inserted into the directives. They would prefer domestic GAARs. Two of them also believed that the GAAR could be improved.

One MS supported amending all three directives, although some work would be needed on the drafting of the GAAR. In a written contribution this MS later reiterated its support for amending the PSD to create an obligation to have an anti-abuse rule.

Stakeholders did not agree on whether to amend the directives with a GAAR or not but business representatives were in general in favour of domestic GAARs instead. On the other hand NGOs and one business representative seemed to favour including a GAAR clause in the directives.

International Context

The issue of corporate tax base erosion is very high in the political agenda of many EU and non-EU countries and has been on the agenda of recent G20 and G8 meetings⁵ as well as at the OECD which is currently working on base erosion and profit shifting ("BEPS").⁶

² European Parliament resolution of 21 May 2013 on Fight against Tax Fraud, Tax Evasion and Tax Havens (2013/2060(INI)).

³ EUCO 75/1/13 REV 1.

⁴ COM(2013)71 final, 14 February 2013.

In March 2012 the OECD also published a Report titled “Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues” which recommended countries should consider introducing or revising rules denying benefits in the case of certain hybrid mismatch arrangements. Hybrid mismatches arrangements and arbitrage have also been identified as a key element in the BEPS project.⁷

While the Commission recognizes the importance of global solutions, there is a need for the EU to address mismatches and abuse taking into account existing EU legislation and the case law of the Court of Justice. The Commission believes that the revision of the PSD can be an important contribution to the OECD BEPS work as it would represent a best practice in fighting base erosion.

2. PROBLEM DEFINITION

Problem description

Hybrid loan mismatches

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

Anti-abuse provision

Article 1(2) of the PSD already permits Member States to adopt domestic anti-abuse provisions. However MS existing anti-abuse measures are very varied, having been designed to address the specific concerns of MS and features of their tax systems leading to a lack of clarity for taxpayers and for tax administrations. The current situation could potentially also lead to improper use of the directive if the anti-abuse provisions in some Member States are less stringent or non-existent.

Who is affected?

Member States are affected because of reduced tax revenues. Businesses are affected because large companies with cross-border operations which can afford to pay for sophisticated tax schemes enjoy a competitive advantage over small and medium-sized companies and large companies not involved in aggressive tax planning. Citizens are indirectly affected by the budget reduction for public services and social benefits. Public confidence in the fairness of the tax system may be affected by the ability of some taxpayers to benefit from mismatches.

Subsidiarity and proportionality

This initiative seeks to tackle certain hybrid financial mismatches using the PSD and introduce a general anti-abuse rule in order to protect the functioning of this directive.

These objectives require an amendment of the PSD. In direct tax matters, the relevant legal basis is Article 115 of the Treaty on the Functioning of the European Union (TFEU) under

⁵ Final declarations of the G20 leaders' meeting of 18-19 June 2012; Communiqué of G20 finance ministers and central bankers governors' meeting of 5-6 November 2012, of 15-16 February 2013 and of 18-19 April 2013; Joint Statement by UK's chancellor of exchequer and Germany's finance minister on the margin of the G20 meeting in November 2012; Communiqué of G8 leaders' summit of 17-18 June 2013.

⁶ OECD, Addressing Base Erosion and Profit Shifting, 2013.

⁷ OECD, Action Plan on Base Erosion and Profit Shifting, 2013,

which the Commission may issue directives for the approximation of provisions of the Member States as directly affecting the functioning of the Internal Market.

The objectives of the initiative cannot be sufficiently achieved unilaterally by the Member States. It is exactly the differences in national legislation concerning the tax treatment of hybrid financing which allow taxpayers, in particular groups of companies, to employ cross-border tax planning strategies which lead to distortions of capital flows and of competition in the Internal Market. Therefore the proposed amendments comply with the subsidiarity principle. The proposed amendments also comply with the proportionality principle as they do not go beyond what is needed to address the issues at stake and, thereby, to achieve the objectives of the Treaties, in particular the proper and effective functioning of the Internal Market.

3. OBJECTIVES

Hybrid loan mismatches

The objective of the initiative is that all companies are taxed on the realised profits in the EU Member State concerned and that companies cannot escape taxation by exploiting loopholes from hybrid financing in cross-border situations. The initiative aims at ensuring effective action against double non-taxation in this area. The application of the PSD should not inadvertently prevent such action.

Anti-abuse provision

The initiative aims at providing certainty and clarity for taxpayers and for tax administrations and at ensuring that companies do not improperly take advantage of the provisions of the PSD.

4. POLICY OPTIONS

Hybrid loan mismatches

The following policy options are considered:

Option A0: No action (baseline scenario)

Option A1: Profit distribution payments which are deductible in the source Member State would be excluded from the PSD.

Option A2: The tax exemption benefits in the PSD would be denied to profit distribution payments which are deductible in the source MS. Accordingly, the MS of the receiving company (parent company or permanent establishment of the parent company) shall tax the portion of the profit distribution payments which is deductible in the MS of the paying subsidiary.

Anti-abuse provision

For the purposes of clarity and certainty, the following alternative ways of improving the anti-abuse provision in the PSD are considered:

Option B0: No action (baseline scenario)

Option B1: Updating the current anti-abuse provisions of the PSD in light of the GAAR proposed in the December 2012 Recommendation on aggressive tax planning. The directive would be amended to include the recommended common anti-abuse rule. Under this option, Member States could choose whether or not to adopt the anti-abuse rule.

Option B2: The same as option B1 with the addition that under this option, it would be an obligation for Member States to adopt the common anti-abuse rule.

5. ANALYSIS OF IMPACTS

Hybrid financial mismatches

The following table summarises the analysis of the impacts (ascending scale from --- to +++)

Expected impact			
	Option A0: No action	Option A1: exclude hybrid loans payments from the PSD*	Option A2: exclude hybrid loan payments from the tax exemption benefits of the PSD
Effectiveness in achieving policy objective	=	+	+++
Four freedoms	=	=	=
Economic impact	=	+	+++
Social impact	=	+	++
Impact on taxpayers/tax administrations	=	+	+++
Impact on EU budget	=	=	=
Impact on other parties	=	=	=

* the expected impacts would be the same as in Option A2 if all MS were to implement the Code of Conduct Group guidance

Anti-abuse provision

The following table summarises the analysis of the impacts (ascending scale from --- to +++)

Expected impact			
	Option B0: No action*	Option B1: optional anti-abuse provision in the PSD*	Option B2: obligatory anti-abuse provision in the PSD
Effectiveness in achieving policy objective	=	+	+++
Four freedoms	=	+	+

Economic impact	=	=	+
Social impact	=	=	=
Impact on taxpayers/tax administrations	=	+	+
Impact on EU budget	=	=	=
Impact on other parties	=	=	=

* the expected impacts would be the same as in Option B2 if all MS were to implement the recommended anti-abuse rule

6. COMPARING THE OPTIONS

Hybrid financial mismatches

Option A0 would not address the double non-taxation issue nor would it allow Member States to implement in their national legislations the political agreed solution in the Code of Conduct Group. The baseline scenario is therefore that the loophole will continue to exist.

Option A1 would be in line with the solution adopted in the Interest and Royalties Directive, but does not address possible double non-taxation caused by hybrid financial payments, so each MS would have to adapt their domestic rules to the Code of Conduct Group guidance in their own way.

Option A2 would be more effective than option A1 in counteracting hybrid financial arrangements and would ensure consistency of treatment across the EU.⁸

Option A2 would help achieve the fundamental purpose of the PSD, i.e. to create a level playing field between groups of companies in different MS and groups in the same MS. The increase in cross-border investments allows cross-border groups to use hybrid financial instruments to exploit mismatches between different national tax systems. This leads to a distortion of competition between cross-border and national groups within the EU, contrary to the purpose of the PSD.

Moreover, option A2 would be in line with the OECD recommendations and the current EU and non-EU political approach against tax base erosion and aggressive tax planning.

Thus Option A2 is the preferred Option.

Anti-abuse provision

Option B0 would not ensure clarity and certainty vis-à-vis anti-abuse provisions. It would not ensure against improper use of the PSD either.

Option B1 would provide the benefits of clarity as the provision would be brought in line with CJEU jurisprudence on abuse of rights, but would not ensure the PSD against abuse.

Option B2 is the only option that would ensure the PSD against abuse. This option would also be more effective than option B1 in achieving a common standard for anti-abuse provisions

⁸ There is a pending proposal in Council to align the shareholding threshold in the Interest and Royalties directive to the 10% of the PSD Proposal for a Council Directive on a common system applicable to interest and royalty payments made between associated companies of different Member States (recast) (COM (2011) 714).

tackling abuse of the PSD. A common anti-abuse provision in all Member States would establish clarity and certainty for all taxpayers and tax administrations. Option B2 would ensure that the anti-abuse measures adopted and implemented by EU Member States will raise no EU compliance issue.

Thus option B2 is the preferred option.

7. MONITORING AND EVALUATION

It is established practice for the Commission to monitor the implementation of EU directives by Member States. The legal changes envisaged by the initiative are so straight forward that it is not necessary to conduct a study of whether the objectives of the initiative are met. It is sufficient to monitor that Member States actually transpose the rules to national legislation.