EU Tax Centre

Issue 220 – November 25, 2013

Proposal to amend the Parent-Subsidiary Directive

European Commission – tax avoidance – double non-taxation – aggressive tax planning – Parent-Subsidiary Directive

On November 25, 2013, the European Commission proposed amendments to the EU Parent-Subsidiary Directive 2011/96/EU ("Directive") in order to close off perceived opportunities for corporate tax avoidance. The proposals consist of an amended anti-avoidance rule and changes to exclude payments on cross border hybrid loans from a tax exemption.

Background

The issue of corporate tax avoidance is very high on the political agenda of many EU and non-EU countries, and the need for action to combat it has been highlighted at recent G20 and G8 meetings. The EU supports this and the Commission published an action plan in December 2012 which included proposals to address perceived loopholes in the Directive (see EuroTaxFlash 209).

On May 22, 2013, the EU reached political agreement on the need for a coordinated approach to fighting base erosion and profit shifting and aggressive tax planning, including a revision of the Directive to be presented by the Commission by the end of 2013.

The primary aim of the Directive is to prevent double taxation of the same income as between members of a corporate group that are based in different Member States. This is achieved by providing for a withholding tax exemption on distributed profits and an exemption or credit for the recipient. The current proposals are aimed at preventing certain perceived abuses of these rules.

Scope of proposed amendments

As envisaged by the European Commission's action plan of 6 December 2012, the current proposals are aimed at preventing certain tax avoidance strategies and to tackle hybrid financial mismatches.

The first change would be an amendment of the anti-abuse provision in the Directive. This ensures Member States adopt a common standard to prevent avoidance of the Directive so that its benefits are only granted on the basis of real economic substance. Specifically, the benefits under the Directive will not apply in the case of "*artificial arrangements"* put in place with the *"essential purpose of obtaining an improper tax advantage"*. For these purposes, arrangements are artificial if they do not reflect "*economic reality*". The proposal also lists a series of situations that are relevant for the existence of artificial arrangements. In its accompanying memo, the Commission gives as an example of the kind of structure

that could be impacted by this rule − and therefore could be denied the benefits of the Directive − an intermediate holding company, described as a "*letter box company with no substance*" that is inserted in a structure to avoid withholding taxes in a Member State.

The second change as envisaged in the Commission's proposal would deny the benefits of the Directive to specific tax planning arrangements such as hybrid loan arrangements. The Commission gives as an example the case where a loan is treated as debt in the Member State of the debtor/subsidiary and as equity in the Member State of the lender/parent, so payments on the loan are deductible in the former and exempt in the latter Member State. Under the proposed amendment, the payments would no longer be exempt in the latter Member State, which would then tax the portion of the payments which is deductible in the Member State of the paying subsidiary.

Next steps

Member States are expected to implement the amended Directive by 31 December 2014. However, the proposal must first be approved by the EU Parliament and the Member States themselves.

Further reading

Press release: Tackling Tax Avoidance – Commission tightens key EU corporate tax rules

Commission Staff Working Document – Impact Assessment accompanying the Proposal for a Council Directive 2011/96/EU

Commission staff working document executive summary of the impact assessment

Commissioner's statement (Speech-13-969)

EU Tax Centre Comment

The current proposals should be seen as part of the increased efforts at the international level to combat aggressive tax planning. As such, the proposal aimed at hybrid loan arrangements could impact certain group financing arrangements where such arrangements are not already limited under domestic rules. The Directive already contains a provision allowing Member States to apply domestic anti-abuse rules and the practical impact of the proposed amendment will therefore depend on the existing application of such rules in individual Member States.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor.

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