Political agreement on anti-tax avoidance directive

On 17 June 2016 the Economic and Financial Affairs Council (ECOFIN) of the EU held discussions with a view to reaching a political agreement on the proposal for an anti-tax avoidance directive (ATAD), which had been a high priority for the Dutch Presidency. In the light of these discussions the Presidency put forward a final compromise text, to which almost all delegations could agree and announced a 'silence' procedure until Monday, 20 June 2016. As no objections were raised by that deadline, political agreement was reached.

The anti-tax avoidance directive is one of the two legislative pillars of the European Commission's Anti-Tax Avoidance Package (ATAP), presented in January 2016. The directive is intended to provide a minimum level of protection for the internal market and strengthen the average level of protection against aggressive tax planning.

In this memorandum we give an overview of the rules laid down in the ATAD and address the impact for the Netherlands.

Overview of the final ATAD compromise

The ATAD lays down common minimum rules in the areas of interest limitation, exit taxation, general anti-abuse rules (GAAR), controlled foreign companies (CFC) and hybrid mismatches. The switch-over clause which was also proposed has been deleted.

- **Interest limitation**: The interest limitation rules take the form of an earnings stripping rule, whereby in principle no deduction would be given for interest exceeding 30% of EBITDA. The rules have been substantially amended to allow for flexibility and exemptions upon transposition, and include de minimis thresholds, escape clauses and a grandfathering provision. Member States which already have national targeted rules (e.g. thin capitalization rules) which are equally effective to the proposed interest limitation rule will have up to 1 January 2024 to implement this provision and phase out their domestic rules, unless an agreement is reached on interest limitation rules at OECD level prior to this date. This will be subject to notification prior to 1 July 2017 of all information necessary for evaluating the effectiveness of the national rules to the European Commission.

- **Exit taxation:** The exit tax rules apply to certain cross-border transfers of assets or residence within the EU or to non-EU countries. The rules broadly reflect EU case law, including a tax deferral mechanism for transfers within the EU/EEA. Member States may defer the implementation of this provision to 31 December 2019 (instead of 2018 for the other provisions).

- **GAAR:** The rule, which is intended to reflect EU case law, will require Member States to ignore arrangements that do not comply with the standard, which consists of both a motive test and a substance test.

- **Controlled foreign companies:** Unlike the Commission's initial proposal, the rules apply to both EU and non-EU CFCs and have been extended to permanent establishments. The CFC's income would become taxable in the 'home' jurisdiction if certain thresholds are met, especially as regards ownership (50%) and level of tax payable compared to what would have been due in the 'home' Member State (de facto effective tax rate of less than 50% of the home jurisdiction). A carve-out clause applies for CFCs that satisfy a substance test, which may be disapplied by Member States for non-EU/EEA CFCs.

- **Hybrid mismatches:** Contrary to the Commission's initial text, the ATAD covers only intra-EU situations involving hybrid entities and hybrid instruments. To the extent a hybrid mismatch results in a double deduction, a deduction shall only be provided in the source state of the payment. If a hybrid mismatch results in a deduction without inclusion, the deduction shall be denied.

The switch-over clause which was also in the proposed text of the ATAD has been deleted.
In addition to the ATAD, the agreement covers a Council statement requesting the Commission to put forward a (legislative) proposal on hybrid mismatches involving third countries by October 2016. The statement is an integral part of the political agreement and intended to satisfy those Member States which were of the opinion that third-country mismatches should have been included in the ATAD.

Finally some Member States' concerns as regards ensuring a level playing field at international level were addressed in a Council statement forming part of the agreement under which the Commission will closely monitor and engage with the OECD with regard to implementing the BEPS recommendations. The European Commission will also be required to provide an impact assessment 4 years after the directive comes into force, and especially of the interest deduction limitation rules.

Next steps

Following this political agreement, the ATAD should be formally adopted without further discussion during the next ECOFIN meeting on 12 July 2016. Member States will then have until 31 December 2018 to implement the main provisions of the directive in their national legislation, which would then apply as from 1 January 2019.

Impact for the Netherlands

For the Netherlands the main amendments to current legislation that must be enacted (stricter provisions are allowed), generally no later than 31 December 2018, are the following:

- Codification of the anti-abuse rules developed by case law (fraus legis doctrine) in conformity with the rules developed by the CJEU, i.e. legislation to ignore arrangements that are carried out for the essential purpose of obtaining a tax advantage and which are contrary to the object or purpose of tax provisions;

- Introduction of a new limitation on the deduction of interest in the form of an earnings stripping rule (limitation of 30% of the taxpayer's EBITDA or EUR 3,000,000, whichever is higher). However, in addition to this limitation Member States may use more targeted rules to limit interest deduction, including thin capitalization rules. Furthermore, the Netherlands may use a grandfathering clause to maintain the current treatment for loans that existed on 17 June 2016;

- Introduction of CFC legislation which may target low taxed passive companies, active group finance companies and indirectly held CFCs. Under certain conditions these types of (in)directly held companies may currently qualify for the participation exemption on the basis of specific facts and circumstances. This could mean a major change as Dutch law currently only provides for specific valuation rules that may apply to directly held passive investment companies. The important question is how the 'substantive economic activity' escape clause will be interpreted and whether this clause will also be applied by the Netherlands to CFCs located in third countries.

- Where exit taxation is concerned, the ATAD rules are not likely to have a major impact; only in the case of transfers within the EU/EEA of a taxpayer's residence and PE assets out of the Netherlands do current Dutch rules seem to be too lenient, since they provide for the possibility of paying the exit tax in installments over 10 years, whereas the ATAD only allows for payment in installments over five years. Implementation of this measure may be deferred to 31 December 2019;

- With respect to hybrid mismatches, Dutch tax law and administrative practice already target certain forms of such mismatches, both in EU and non-EU situations, but only in certain specific situations.

Meijburg & Co
June 2016

The information contained in this memorandum is of a general nature and does not address the specific circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.