Euro Tax Flash from KPMG's EU Tax Centre

ECOFIN approves new anti-hybrid rules at meeting of February 21, 2017

ECOFIN — Anti-Tax Avoidance Directive 2 - Third country hybrids – EU Blacklist

On February 21, 2017 the Economic and Financial Affairs Council of the EU (ECOFIN) reached an agreement on the general approach proposed by the Maltese Presidency on the adoption of the proposal for a Council Directive as regards hybrid mismatches with third countries (ATAD2).

Background

This proposal is part of the Commission's corporate tax package published on October 25, 2016 (see ETF 303) and is foreseen as an amendment to the EU Anti-tax Avoidance Directive (ATAD1). (See ETF 289)

The adoption of ATAD2 was a high priority for the previous Slovak Presidency, but on December 6, 2016 EU Member States were not yet in a position to reach an agreement. The main points of the discussion were the scope of the carve-out options and the implementation date of the proposal. (See ETF 306) The delegations have now agreed on these substantive issues.

Anti-Tax Avoidance Directive 2 - hybrid mismatches with third countries

Hybrid mismatches occur when countries have different rules for the tax treatment of certain income or entities. ATAD1 applies to hybrid mismatches arising from differences in the legal characterisation of a financial instrument or entity, and provides that, if a hybrid mismatch results in a double deduction, a deduction shall only be provided in the source state of the payment, and if it results in a deduction without inclusion, the deduction shall be denied. The compromise agreement changes these rules, in particular by introducing 'secondary rules', to cover the possibility that the state in question does not apply the main, or 'primary' rules.

Contrary to the initial plans of the European Commission, ATAD1 covered only intra-EU situations. The ATAD2 compromise extends the scope of these rules to hybrid mismatches between EU Member States and third countries.

The compromise agreement also extends the scope of the hybrid situations that are covered by ATAD1. In particular, ATAD 2 would also apply to the following situations: reverse hybrids, income allocation mismatches and deemed payments involving permanent establishments, hybrid permanent establishments, imported mismatches, hybrid transfers resulting in multiple relief for withholding tax, and dual residency resulting in double deductions.

According to the compromise agreement there is a carve-out option up to December 31, 2022 for hybrid regulatory capital in the banking sector. There is also a carve-out for financial traders involving hybrid transfers made in the ordinary course of business. The general application date of ATAD2 is January 1, 2020. This is one year later than ATAD1, which in most respects shall apply from January 1, 2019. However, a specific provision of ATAD2 in terms of reverse hybrids shall become effective only as from January 1, 2022 in domestic legislation.

Next steps

The compromise text of the ATAD2 proposal will now be adjusted by the Presidency accordingly and will be submitted to a later ECOFIN meeting for formal adoption once the European Parliament has given its (informal) opinion.

Besides ATAD2, Member States are also working on a number of other substantial corporate tax reforms which have been proposed by the European Commission. (See ETF 303, ETF 304 and ETF 306)

Developing a common EU list of third country tax jurisdictions that do not conform to international good governance tax standards has also been discussed in today's ECOFIN meeting, and, in line with the outcome of the

ECOFIN meeting held last December, the list should be ready by the end of this year. (See ETF 301 and ETF 304)

EU Tax Centre comment

This compromise agreement represents the end of the political discussions on how to implement the OECD's work on hybrid mismatches into a common EU set of rules. The practical implications for existing and future arrangements will need to be carefully addressed once the final text has been published.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

Robert van der Jagt
Chairman, KPMG's EU Tax Centre and
Partner,
Meijburg & Co

Barry Larking
Director EU Tax Services, KPMG's EU Tax Centre and
Director,
Meijburg & Co

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KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands