



The European Commission's Anti Tax Avoidance Package

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On 28 January 2016, the European Commission (EC) presented its Anti Tax Avoidance Package ([here](#)). This includes two legislative proposals: a directive addressing certain anti-base erosion and profit shifting (BEPS) issues and an amendment to the Directive on Administrative Cooperation to include non-public country-by-country reporting (CBCR). It also contains a Communication on an External Strategy for Effective Taxation, which proposes a common approach to tax good governance towards third countries, and a Recommendation on Tax Treaties.

The new package aims to address tax abuse, ensure sustainable revenues and foster a better business environment in the internal market, and covers the following areas of taxation:

- The deductibility of interest;
- Exit taxation;
- A switch-over clause (addressing the taxation of foreign income and gains);
- A general anti-abuse rule (GAAR);
- Controlled foreign company (CFC) rules;
- A framework to tackle hybrid mismatches;
- Mandatory automatic exchange of information regarding CBCR;
- A tax treaty GAAR;
- Permanent establishment definition.

In addition to the above, the Communication on an External Strategy for Effective Taxation sets out a proposed approach for good tax governance for third parties. This includes proposals in relation to increased tax transparency, fairer tax competition and a framework for categorising third countries based on their governance standards. We have not provided UK specific commentary on this communication as its scope focuses on the broader European response, rather than requiring local country implementation. However, it remains of interest and relevance to UK business and developments should be monitored as the debate continues.

We refer to KPMG's EU Tax Centre Tax Flash ([ETF 273](#)) for further details of all the proposals at a pan European level. As noted in ETF 273, the proposals put forward by the EC require unanimous approval from all 28 Member States

before becoming law. Whilst it is acknowledged that the EC is pressing for the quick adoption of the proposals, it is unclear at this stage how feasible this is at both a political and practical level. Regardless of this, the proposals do provide a valuable insight into the "direction of travel" and wider intentions of the EC.

The purpose of this communication is to provide a UK perspective of the proposals, in particular for those groups which are either UK parented, or with a significant UK sub-group and UK operations.

Measures consistent with the OECD's BEPS Action Plan

The EC has supported the OECD's BEPS Action Plan from the outset and strongly support the adoption of their recommendations. There is clearly concern within the EC that the outputs of the BEPS Action Plan could be implemented by Member States in an inconsistent and divergent manner, which may not adequately tackle the problem of aggressive tax planning, leading to additional uncertainty and administrative burden for businesses.

With this in mind, the EC Package includes proposals for the common implementation of certain OECD proposals. Where the EC's proposals are broadly in line with the OECD recommendations we would not expect this to cause significant concern for UK clients. Proposals falling into this category relate to: prevention of treaty abuse (BEPS Action 6), definition of permanent establishment (BEPS Action 7) and the comment of support for the revised OECD guidelines on transfer pricing (BEPS Actions 8-10).

Measures which differ from the OECD's BEPS Action Plan

However, as acknowledged by the EC, there are certain areas where the package goes much further than stewardship of the implementation of BEPS measures in the EU, both in terms of approach and breadth of the proposals. It is these areas which we anticipate will cause concern to UK business, as they add a further layer of complexity and uncertainty to the implementation of the BEPS Actions.

Hybrid mismatches

Firstly there are specific proposals in relation to tackling hybrid mismatches that focus on legal characterisation of instruments and entities which are at odds with the OECD's recommendations. The EC propose that where there is a difference in legal characterisation of an entity or instrument held between two Member States, the legal characterisation should follow the form in the source country. This is a different approach to the OECD's recommendations, which require the effect of the mismatch to be neutralised for tax purposes (rather than a deemed change to the underlying legal characterisation).

This results in a number of concerns. Firstly, how will the EC's proposals interact with the OECD proposals in those cases where the local jurisdiction has adopted the OECD's recommendations – and what is the impact if only one of the parties to the transaction has implemented the OECD's recommendations? Secondly, these proposals also introduce a two tier approach to dealing with hybrid mismatches depending on whether they are intra-EU, or with a third country.

It is also unclear how the rule would work where a hybrid entity makes a payment and both jurisdictions would be the source country of that payment under domestic law.

For UK groups, the UK Government have provided clear statements and draft legislation in respect of the UK's adoption of the OECD's recommendations. There is no expectation that the UK Government will change the draft legislation in line with the EU anti-BEPS directive. However, should other EU countries adopt the EU approach it could lead to uncertainty of how the various anti-hybrid rules interact with each other, increasing the risk of double taxation or disputes.

Interest deductibility

Another area where the EC has diverged from the OECD's recommendations is interest deductibility. The OECD recommendations take the form of a framework to allow countries to adopt a regime which applies the concept of a Fixed Ratio Rule (FRR) but retains flexibility that, to the extent possible, allows new rules to more closely reflect their historic approach.

Whilst adopting many of the principles of the OECD, the EC have gone further by stipulating more precisely how EU countries should adopt the interest deductibility recommendations. This includes fixing the FRR at 30 % of

tax EBITDA, applying a de minimis level of only €1,000,000 and no scope for the inclusion of a public benefit project exclusion.

In addition, although the EC package incorporates a version of the Group Ratio Rule (GRR) that is similar to that set out in the OECD recommendations, the EC have suggested this should be with reference to a balance sheet asset based test. Specifically, the EC recommend that the entity level ratio of equity to total assets is compared to that for the Group as a whole, whereas the OECD recommendations propose a rule based on a P&L test of net interest/EBITDA. It is difficult to see how EC countries could align their interest deductibility rules with the OECD recommendations when the EC are making alternative and contrasting best practice recommendations.

Overall, for UK business these proposals are unlikely to be attractive as they further narrow the boundaries for a regime which has already met with significant public comment.

CFC rules

The proposals in respect of CFC rules also appear to diverge from the OECD recommendations. The OECD recommendations were not minimum standards, and instead recognised CFC rules to be an area where countries will want to implement the most appropriate regime to complement their wider tax corporate tax strategy. The OECD proposals therefore set out six "building blocks", with the current UK CFC regime appearing to fit within these.

The EC Package however proposes a much more rigid framework, centred on an effective tax rate test: where profits (arising outside the EU) are subject to an effective tax rate of lower than 40% of the effective tax rate that would have applied under the relevant Member State's regime, a CFC charge may arise. An immediate concern for UK tax payers will be the potential impact on the UK's FinCo regime, alongside a broader concern that this stricter framework may require wider change to the UK CFC regime leading to uncertainty for business.

Measures outside of the OECD's BEPS Action Plan

There are a number of proposals which are not part of the BEPS Action Plan contained in the proposed Directive in relation to a switch-over clause, exit taxation and a general anti-abuse rule (GAAR). In addition the Commissioner has stated that the EC may go further and implement public BCR following an additional impact assessment.

Switch-over clause

The switch-over clause proposes the taxation of foreign income received as a dividend from, or profit on the disposal of shares in, an entity that is resident outside of the EU or income from a permanent establishment (PE) situated outside of the EU, where the entity or PE is subject to local corporate tax at a rate lower than 40% of the statutory rate of the Member State receiving the income.

For UK taxpayers, this could eliminate the relief available

under the distribution exemption, the substantial shareholding exemption and the foreign branch exemption when the entity or PE is subject to tax at a rate lower than 8% (based on a current statutory rate of 20%). This would be a significant departure from these well-established and understood exemptions, and the uncertainty over their potential future application for certain transactions is likely to be concerning for UK business.

Furthermore given that there are already anti-avoidance provisions in the UK rules and the UK has CFC rules, it is difficult to justify a blanket restriction on exempting profits from low tax entities – even when the structures are purely commercial. Such a proposal is a step towards requiring a minimum level of taxation, which the EC has generally not supported.

Exit charges

Similarly, the proposals in relation to exit charges are likely to be of equal concern. Broadly, these propose a tax on transfers of assets (or on migration of tax residency) within the EU. The proposals include a mechanism to spread the tax over a number of years. Under current UK legislation, an exit tax is due on such transfers or migrations outside of the EU. However, within the EU a deferral is possible, subject to certain requirements and anti-avoidance provisions, until such time as the assets (or entity) leave the EU. If the assets (or entity) do not leave the EU, no exit charge would arise. Therefore, even with the concession to staggered taxation, this could be a significant change to the basis of taxation for UK taxpayers.

GAAR

The proposals in respect to the GAAR go above and beyond those of the OECD. The UK already has a GAAR although we have yet to see how it is applied in practice. It is likely that the UK will consider that it already meets this requirement and therefore the impact of an EU GAAR may be limited for UK taxpayers.

CBCR

In respect of CBCR, the EC Package includes a proposal to introduce the automatic exchange of information between Member States on their tax rulings. This does not extend the reporting obligations on corporates over and above the OECD recommendations, although it may mean that the information is shared more widely between tax authorities.

The public reporting of CBCR would extend beyond the recommendations of the OECD, but it is however subject to consultation of the EC (rather than a direct recommendation). The EC aims to present a decision on this matter in early spring 2016. Within the EU such requirements already exist for the banking sector and for logging and extractive industries, and the proposals note that there is an “ambitious tax transparency agenda within the Single Market, which goes further than international requirements”. UK parented multinational groups may wish to factor this into their planning for CBCR, as additional explanations and reconciliations might be required to ensure

that the report is interpreted accurately by a wide variety of users.

Direct effect of the Directive

Once agreed by the Member States and having come into effect, any Directive would have direct effect which, broadly, means that a taxpayer could claim any benefits of the Directive even if a Member State had failed to implement it. Conversely a Member State could not ‘pray in aid’ its own breach of the Directive against a taxpayer. It is therefore conceivable that a taxpayer may claim to apply the Directive against a Member State which adopted the OECD definitions rather than the EU ones if that gave the taxpayer a more favourable outcome. Clearly any such dispute creates uncertainty for all concerned.

Overall UK Comment

It is critically important that, given wholesale change to the international tax landscape is taking place, there is consistency in how changes are introduced. Clearly these are proposals at this stage, and it is important that due process is followed with proper consultation with stakeholders, particularly business, to ensure that the final rules are targeted at the mischiefs that the OECD BEPS Action Plan had intended to target without undermining the EU’s competitiveness within the global market.

The EC Package does not currently include a formal consultation process. It would therefore be necessary for interested parties wishing to make a representation to do so directly with HMRC/HMT (or through relevant industry bodies) and to request that comments are provided to Ministers negotiating at the Council level. Alternatively, stakeholders could provide comments to their MEP.

We would anticipate that consultation, whether formal or informal, will take place in two steps: firstly, to gather the views of stakeholders on how the UK should respond to the Directive, including any particular points of concern on the proposals put forward by the EC, and secondly, once the UK’s position has been agreed, a further consultation on the most appropriate and effective implementation mechanism(s) to incorporate the proposals into the UK tax code.

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