Federation of European Accountants

Pierre Moscovici
Commissioner
DG TAXUD, European Commission

Brussels, 30 May 2016

Subject: The Federation comments on the European Commission's Anti-Tax Avoidance Directive (ATAD)

Dear Sir, Madam,

The Federation of European Accountants (the Federation) has the following comments on the European Commission's proposed Directive 2016/011 laying down rules against tax avoidance practices – commonly known as the *Anti-Tax Avoidance Directive* (ATAD).

1) Ensure implementation of OECD/G20 BEPS recommendations in the EU

We fully support the recommendations to tackle base-erosion and profit shifting (BEPS), as prepared by the Organisation for Economic Co-operation and Development (OECD) and approved by the G20. We are also in favour of a consistent transposition of the BEPS recommendations into EU law as proposed in the European Commission's ATAD.

2) Carefully assess the impact of non-BEPS measures

Certain provisions in the ATAD go beyond what is proposed in the OECD/G20 BEPS recommendations. We encourage the European Commission, Member States, and the European Parliament to carefully assess the impact of these provisions in order to ensure that they achieve the intended effects, a level playing field, and do not pose unnecessary risks or burdens to the EU economy.

3) Limit the scope of the proposal to groups

The Explanatory Memorandum and Preamble to the ATAD make several references to the objective of the proposal being the fight against tax avoidance. However, most of the tax avoidance strategies addressed by the ATAD – such as CFC legislation, the interest limitation rule, the switch-over clause and hybrid mismatches – require multinational group structures. Some of the proposals, in particular those relating to the deductibility of interest, may have an impact on singleton companies, not only on groups. We consequently encourage the European Commission, Member States, and the European Parliament to carefully assess whether the scope of the ATAD ("all taxpayers that are subject to corporate tax in one or more Member State") goes beyond the stated purpose of fighting tax avoidance.

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

4) Other specific comments:

Interest limitation rule – the one million euro threshold is too low for some Member States and may affect many businesses. Instead, a three million euro threshold would be more appropriate, as already implemented by some Member States. This would ensure that more groups are able to take advantage of the threshold. Furthermore, the third party interest incurred by the group as a whole should be fully deductible.

Exit taxation and General Anti-Abuse Rule (GAAR) – there is a need for a consistent implementation of these rules across the EU from both business and tax authorities' perspectives. On GAARs specifically, their increased use in Member States will lead to a greater number of tax disputes. We therefore call for a stronger tax dispute resolution mechanism within the EU.

Switch-over clause and CFC legislation – the Commission proposes that these two provisions are applicable when the taxpayer has capital income or reported profits in a low tax jurisdiction. Such "low tax countries" are defined by the Commission as the difference between the tax rate of the third country of origin and that of the hosting Member State. This risks leading to situations where the same third country is defined as having or not having a low tax rate by different Member States.

We recommend instead to base the calculation and definition of a low tax jurisdiction on the basis of an average of EU corporation tax rate. This will lead to a consistent interpretation of "low tax countries". It will also reduce the incentive to engage in harmful tax competition by Member States or for business to obtain a tax advantage by moving the residence of the taxpaying company to low tax jurisdictions within the EU.

We hope that you will find the comments above useful (further expanded in the Annex). For additional information on this letter, please contact Paul Gisby, Manager, from the FEE Team on +32 2 893 33 70 or via e-mail at paul.gisby@fee.be.

Sincerely,
On behalf of the Federation of European Accountants,

Petr Kriz President	Olivier Boutellis-Taft Chief Executive

About the Federation of European Accountants

The Federation of European Accountants represents 50 professional institutes of accountants and auditors from 37 European countries, with a combined membership of over 875,000 professional accountants working in different capacities. As the voice of the European profession, the Federation recognises the public interest.

The Federation is in the EU Transparency Register (No 4713568401-18).

Annex 1 - Detailed comments on the ATAD provisions

Interest limitation rule (Article 4)

The Commission proposes that borrowing costs can be offset in full against "taxable revenue from financial assets" and that any excess borrowing costs after offset shall be deductible only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA) or up to an amount of €1 million, "whichever is higher".

(1) This measure aims to combat tax avoidance structures used by multinational groups. It can result in interest deductions across the group being greater than the total interest paid to third parties. It can also result in the shifting of income from high tax jurisdictions to low or no tax jurisdictions. This is due to group loans being organised so that the loan making company is based in a jurisdiction that levies little tax on interest income, yet the interest paying company gets full tax relief for interest paid.

(2) On this basis, it would seem logical that:

a. article 4 only applies to companies within a multinational group – the current article applies to all companies

b. interest paid by the group to third parties can be fully offset by the group – i.e. the maximum interest that can be deducted by the group as a whole does not exceed that paid to third parties

(3) The interest limitation rule will have the largest impact on non-group companies, especially where their business model is based on high levels of borrowing or where they find themselves forced to borrow more funds because of financial exigencies. Such companies have no means to "inflate" interest by borrowing from other group companies based in low-tax jurisdictions – their financing structure is a matter of commercial reality rather than tax avoidance.

(4) The Explanatory Memorandum mentions "mitigating the bias against equity finance" as possible being the objective of limiting the interest deductions of singleton companies. Whilst debt-equity bias is an important issue, it is not appropriate to deal with it in a Directive focused on combatting tax avoidance.

(5) The solution would be to narrow the applicability of the interest limitation rule cover only to multinational group companies. This would mean better alignment with the scope of the BEPS Action 4 (*Interest Deductions and Other Financial Payments*).

(6) The interest limitation rule includes additional potential issues. First, the €1 million threshold proposed in Paragraph 2 is too low for some Member States and would lead to an excessive number of companies being unable to apply the rule. A higher threshold of, for example, €3 million would be preferable, as this would ensure more groups to be able to take advantage of the threshold. This is already the case in certain Member States, such as France and Germany.

(7) Second, the facility in Paragraphs 4 and 5 to carry forward the "exceeding borrowing costs" and EBITDA that cannot be deducted or absorbed in the current tax period should be extended to include unused interest capacity.

(8) Third, there are also issues in ensuring that the measurement of EBITDA is consistent across different companies in different Member States. This is less of an issue for multinational groups using the IFRS, but more problematic to ensure consistent calculation of EBITDA for smaller companies using local GAAP. This would be less problematic if the article was to only apply to cross-border groups.

Exit taxation (Article 5)

The Commission proposes that all Member States apply an exit tax on corporate assets when they, or the tax residence of the taxpayer owning them, are moved from their territory to another Member State or to a third country.

(9) Currently, there is no common approach across the EU on exit taxes. This makes it particularly difficult to establish a common European standard applicable across all 28 Member States, and increases the likelihood of double-taxation occurring – especially where assets leave the EU to third countries.

(10) The impact of the proposed common approach across the EU – even if as a minimum standard – should be carefully assessed in order to avoid unintended consequences and double-taxation.

(11) Stakeholders raised concerns as to whether the provisions on exit taxation are in line with the EU's fundamental freedoms, in particular with the free movement of capital, and the relevant Court of Justice of the EU (CJEU) case law. This is especially the case where abusive practices are either not taking place or are highly unlikely. The Commission's proposal provides for deferral of the exit taxation payment, and argues that this ensures the compliance of the provision with relevant case law. Given the concerns raised, due consideration should be given for a more comprehensive legal analysis of the potential impacts of the proposed exit taxation provisions on the movement of capital in the Single Market. This might also have an impact on the Commission's stated goals for the Capital Markets Union.

(12) Similar to concerns raised in the section on interest limitation, Article 5 Paragraph 3 discriminates against non-group companies. It specifies that the provisions concerning the deferral of exit taxation payments do not apply if a company's tax debt is recoverable through another entity belonging to the same group.

(13) With the exception of the reservations above, the exit taxation proposal is broadly in line with existing similar provisions in some Member States, despite differences between Member States. This means that it would suffer from the same practical problems as the national provisions – such as valuation of intangibles and whether the exit tax valuation includes an element for the future profits moved between jurisdictions.

Switch-over clause (Article 6)

The Commission proposes that profit distributions, capital gains on shares and branch income derived from an entity located in a low-tax third country whose statutory profit tax rate is lower than 40% of the recipient Member State's statutory rate, will have to be taxed in that Member State

(14) The proposed switch-over clause represents a broad departure from the exemption system – widely regarded as efficient and supportive of the capital import neutrality principle – towards a tax credit system. It would put an end to the participation exemption-principle, which is a feature of existing tax legislation in several EU Member States. Participation exemption is based on the principle that profits should only be taxed once – i.e. at the level of the profit generating entity and not additionally at the level of the entity which receives the profit distribution.

(15) Article 6 is very widely drawn and may catch transactions with genuine commercial substance – for example, where passive income is received from low tax environments. It would be better to follow the example of some Member States, such as Austria, which has a switch-over clause applicable only to situations where abuse occurs.

(16) Another possible option to consider would be to limit the switch-over clause only to cases where a double-taxation agreement does not exist between a Member State and the third country concerned.

(17) It is unclear how the switch-over clause would function in parallel with the proposed approach on Controlled Foreign Companies (CFC). The risk of double- or multiple-taxation together with the CFC proposals cannot be excluded, and careful consideration should be given for the possible impact and interactions between these two provisions.

(18) A low level of taxation, as defined in Paragraphs 1, leads to situations where different Member States qualify the same third country as either low or non-low tax jurisdiction. This is due to the fact that the calculation of what constitutes low taxation depends on the effective corporate income tax level in each Member State. Basing the calculation on the average corporate income tax rate within in the EU could deal with this problem. It would also reduce the possibility that this measure actually encourages both a 'race to the bottom' tax competition between countries or companies relocating to lower tax jurisdictions.

(19) The objective behind Article 6 Paragraph 2 (which excludes the switch-over clause for losses arising from permanent establishment or disposal of shares in an entity resident in a third country) is unclear and subject to different interpretations. We assume that this means the losses, presumably unrelieved by any other means, cannot be offset against profits arising from the same source.

(20) Such being the case, not only would this appear to be inequitable, it also does not appear to have a consistent basis. In addition, it should be clarified whether such an approach would be in contradiction of relevant CJEU decisions, such as Lidl Belgium. We request greater clarity in the drafting of this Paragraph and also an indication as to why its inclusion was considered necessary.

General Anti-Abuse Rule – GAAR (Article 7)

The Commission proposes that non-genuine arrangements that are carried out for the specific purpose of obtaining a tax advantage that defeats the object or purpose of applicable tax provisions should be ignored for the purposes of calculating the corporate tax liability.

(21) Several Member States already have differing national GAAR provisions, whilst others are contained in specific European Directives. More coordination between these different provisions would improve certainty for both business and tax authorities. It is difficult to apply a GAAR consistently across Member States if it is interpreted in different ways by national tax authorities and courts.

(22) The increasing implementation of GAARs in national and European legislation will result in more disputes between taxpayers and tax authorities, but also between two or more tax authorities where there is a significant cross-border element. Consequently, it is essential that the enhanced dispute resolution process, currently under consideration by the Commission, is expedited.

(23) It should be specified in the Directive that the GAAR in question relates only to corporate income tax – VAT should be specifically excluded as it already has a well-developed EU body of law.

Controlled Foreign Company (CFC) legislation (Article 8)

The Commission proposes that a Member State where the parent company is located may tax any profits that the company recognises in a no or low tax third country if the effective tax rate in this country is less than 40% of the Member State concerned.

(24) The CFC provisions as proposed could be improved and rendered more compatible with the existing systems in Member States by a number of adjustments. First, in order to enable Member States to maintain the same approach for both intra-EU and third countries situations, they should have the option between an entity-based and a transactional approach as proposed in the OECD BEPS Action 3.

(25) Second, as already mentioned in point 20, using an EU average tax rate to determine 'low tax countries' under Paragraph 1 (b) would potentially lead to a greater consistency of approach between Member States. It would also reduce the possibility of the clause actually increasing harmful tax competition or providing incentives for businesses to relocate to lower tax jurisdictions.

(26) Third, a definition, or at least a guidance of what is meant, of the term "wholly artificial" should be provided.

Hybrid mismatches (Article 9)

The Commission proposes that in the event of a hybrid mismatch, the legal characterisation given to a hybrid instrument or entity by the Member State where a payment originates shall be followed by the Member State of destination.

(27) The Commission proposal is considerably different from what is recommended by the OECD and G20 as part of the BEPS project. The project states that the relevant BEPS recommendations apply only to intra-group structures, whilst here no such distinction is made. We recommend that the proposal in the draft Directive be aligned with that in the OECD's BEPS recommendations.