Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 115 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Parliament[(1)],

Having regard to the opinion of the European Economic and Social Committee[(2)],

Acting in accordance with a special legislative procedure,

Whereas:

(1) The current political priorities in international taxation highlight the need for ensuring that tax is paid where profits and value are generated. It is thus imperative to restore trust in the fairness of tax systems and allow governments to effectively exercise their tax sovereignty. These new political objectives have been translated into concrete action recommendations in the context of the initiative against base erosion and profit shifting (BEPS) by the Organisation for Economic Cooperation and Development (OECD). The European Council has welcomed this work in its conclusions of 13-14 March 2013 and 19-20 December 2013. In response to the need for fairer taxation, the Commission, in its communication of 17 June 2015 sets out an action plan for fair and efficient corporate taxation in the European Union.

(2) The final reports on the 15 OECD Action Items against BEPS were released to the public on 5 October 2015. This output was welcomed by the Council in its conclusions of 8 December 2015. The Council conclusions stressed the need to find common, yet flexible, solutions at the EU level consistent with OECD BEPS conclusions. In addition, the conclusions supported an effective and swift coordinated implementation of the anti-BEPS measures at the EU level and considered that EU directives should be, where appropriate, the preferred vehicle for implementing OECD BEPS conclusions at the EU level. It is essential for the good functioning of the internal market that, as a minimum, Member States implement their commitments under BEPS and more broadly, take action to discourage tax avoidance practices and ensure fair and effective taxation in the Union in a sufficiently coherent and coordinated fashion. In a market of highly integrated economies, there is a need for common strategic approaches and

coordinated action, to improve the functioning of the internal market and maximise the positive effects of the initiative against BEPS. Furthermore, only a common framework could prevent a fragmentation of the market and put an end to currently existing mismatches and market distortions. Finally, national implementing measures which follow a common line across the Union would provide taxpayers with legal certainty in that those measures would be compatible with Union law.

(3) It is necessary to lay down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market. As these rules would have to fit in 28 separate corporate tax systems, they should be limited to general provisions and leave the implementation to Member States as they are better placed to shape the specific elements of those rules in a way that fits best their corporate tax systems. This objective could be achieved by creating a minimum level of protection for national corporate tax systems against tax avoidance practices across the Union. It is therefore necessary to coordinate the responses of Member States in implementing the outputs of the 15 OECD Action Items against BEPS with the aim to improve the effectiveness of the internal market as a whole in tackling tax avoidance practices. It is therefore necessary to set a common minimum level of protection for the internal market in specific fields.

(4) It is necessary to establish rules applicable to all taxpayers that are subject to corporate tax in a Member State. Considering that it would result in the need to cover a broader range of national taxes, it is not desirable to extend the scope of this Directive to types of entities which are not subject to corporate tax in a Member State; that is, in particular, transparent entities. Those rules should also apply to permanent establishments of those corporate taxpayers which may be situated in other Member State(s). Corporate taxpayers may be resident for tax purposes in a Member State or be established under the laws of a Member State. Permanent establishments of entities resident for tax purposes in a third country should also be covered by those rules if they are situated in one or more Member State.

(5) It is necessary to lay down rules against the erosion of tax bases in the internal market and the shifting of profits out of the internal market. Rules in the following areas are necessary in order to contribute to achieving that objective: limitations to the deductibility of interest, exit taxation, a general anti-abuse rule, controlled foreign company rules and rules to tackle hybrid mismatches. Where the application of those rules gives rise to double taxation, taxpayers should receive relief through a deduction for the tax paid in another Member State or third country, as the case may be. Thus, the rules should not only aim to counter tax avoidance practices but also avoid creating other obstacles to the market, such as double taxation.

(6) In an effort to reduce their global tax liability, groups of companies have increasingly engaged in BEPS, through excessive interest payments. The interest limitation rule is necessary to discourage such practices by limiting the deductibility of taxpayers' exceeding borrowing costs. It is therefore necessary to fix a ratio for deductibility which refers to a taxpayer's taxable earnings before interest, tax, depreciation and amortisation (EBITDA). Member States could decrease this ratio or place time limits or restrict the amount of unrelieved borrowing costs that can be carried forward or back to ensure a

higher level of protection. Given that the aim is to lay down minimum standards, it could be possible for Member States to adopt an alternative measure referring to a taxpayer's earnings before interest and tax (EBIT) and fixed in a way that it is equivalent to the EBITDA-based ratio. Member States could in addition to the interest limitation rule provided by this Directive also use targeted rules against intra-group debt financing, in particular thin capitalisation rules. Tax exempt revenues should not be set off against deductible borrowing costs. This is because only taxable income should be taken into account in determining how much interest may be deducted.

(7) Where the taxpayer is part of a group which files statutory consolidated accounts, the indebtedness of the overall group at worldwide level may be considered for the purpose of granting taxpayers entitlement to deduct higher amounts of exceeding borrowing costs. It may also be appropriate to lay down rules for an equity escape provision, where the interest limitation rule does not apply if the company can demonstrate that its equity over total assets ratio is broadly equal to or higher than the equivalent group ratio. The interest limitation rule should apply in relation to a taxpayer's exceeding borrowing costs without distinction of whether the costs originate in debt taken out nationally, cross-border within the Union or with a third country, or whether they originate from third parties, associated enterprises or intra-group. Where a group includes more than one entity in a Member State, the Member State may consider the overall position of all group entities in the same State, including a separate entity taxation system to allow the transfer of profits or interest capacity between entities within a group, when applying rules that limit the deductibility of interest.

(8) To reduce the administrative and compliance burden of the rules without significantly diminishing their tax effect, it may be appropriate to provide for a safe harbour rule so that net interest is always deductible up to a fixed amount, when this leads to a higher deduction than the EBITDA-based ratio. Member States could reduce the fixed monetary threshold in order to ensure a higher level of protection of their domestic tax base. Since BEPS in principle takes place through excessive interest payments among entities which are associated enterprises, it is appropriate and necessary to allow the possible exclusion of standalone entities from the scope of the interest limitation rule given the limited risks of tax avoidance. In order to facilitate the transition to the new interest limitation rule, Member States could provide for a grandfathering clause that would cover existing loans to the extent that their terms are not subsequently modified, i.e. in case of a subsequent modification, the grandfathering would not apply to any increase in the amount or duration of the loan but would be limited to the original terms of the loan. Without prejudice to State aid rules, Member States could also exclude exceeding borrowing costs incurred on loans used to fund long-term public infrastructure projects considering that such financing arrangements present little or no BEPS risks. In this context, Member States should properly demonstrate that financing arrangements for public infrastructure projects present special features which justify such treatment vis-à-vis other financing arrangements subject to the restrictive rule.

(9) Although it is generally accepted that financial undertakings, i.e. financial institutions and insurance undertakings, should also be subject to limitations to the deductibility of interest, it is equally acknowledged that these two sectors present special features

which call for a more customised approach. As the discussions in this field are not yet sufficiently conclusive in the international and Union context, it is not yet possible to provide specific rules in the financial and insurance sectors and Member States should therefore be able to exclude them from the scope of interest limitation rules.

(10) Exit taxes have the function of ensuring that where a taxpayer moves assets or its tax residence out of the tax jurisdiction of a State, that State taxes the economic value of any capital gain created in its territory even though that gain has not yet been realised at the time of the exit. It is therefore necessary to specify cases in which taxpayers are subject to exit tax rules and taxed on unrealised capital gains which have been built in their transferred assets. It is also helpful to clarify that transfers of assets, including cash, between a parent company and its subsidiaries fall outside the scope of the envisaged rule on exit taxation. In order to compute the amounts, it is critical to fix a market value for the transferred assets at the time of exit of the assets based on the arm's length principle. In order to ensure the compatibility of the rule with the use of the credit method, it is desirable to allow Member States to refer to the moment when the right to tax the transferred assets is lost. The right to tax should be defined at national level. It is also necessary to allow the receiving State to dispute the value of the transferred assets established by the exit State when it does not reflect such a market value. Member States could resort to this effect to existing dispute resolution mechanisms. Within the Union, it is necessary to address the application of exit taxation and illustrate the conditions for being compliant with Union law. In those situations, taxpayers should have the right to either immediately pay the amount of exit tax assessed or defer payment of the amount of tax by paying it in instalments over a certain number of years, possibly together with interest and a guarantee.
Member States could request, for this purpose, the taxpayers concerned to include the necessary information in a declaration. Exit tax should not be charged when the transfer of assets is of a temporary nature and the assets are set to revert to the Member State of the transferor, where the transfer takes place in order to meet prudential capital requirements or for the purpose of liquidity management or when it comes to securities' financing transactions or assets posted as collateral.

(11) General anti-abuse rules (GAARs) feature in tax systems to tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions. GAARs have therefore a function aimed to fill in gaps, which should not affect the applicability of specific anti-abuse rules. Within the Union, GAARs should be applied to arrangements that are not genuine; otherwise, the taxpayer should have the right to choose the most tax efficient structure for its commercial affairs. It is furthermore important to ensure that the GAARs apply in domestic situations, within the Union and vis-à-vis third countries in a uniform manner, so that their scope and results of application in domestic and cross-border situations do not differ. Member States should not be prevented from applying penalties where the GAAR is applicable. When evaluating whether an arrangement should be regarded as non-genuine, it could be possible for Member States to consider all valid economic reasons, including financial activities.

(12) Controlled foreign company (CFC) rules have the effect of re-attributing the income of a low-taxed controlled subsidiary to its parent company. Then, the parent company

becomes taxable on this attributed income in the State where it is resident for tax purposes. Depending on the policy priorities of that State, CFC rules may target an entire low-taxed subsidiary, specific categories of income or be limited to income which has artificially been diverted to the subsidiary. In particular, in order to ensure that CFC rules are a proportionate response to BEPS concerns, it is critical that Member States that limit their CFC rules to income which has been artificially diverted to the subsidiary precisely target situations where most of the decision-making functions which generated diverted income at the level of the controlled subsidiary are carried out in the Member State of the taxpayer. With a view to limiting the administrative burden and compliance costs, it should also be acceptable that those Member States exempt certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance. Accordingly, it is necessary that the CFC rules extend to the profits of permanent establishments where those profits are not subject to tax or are tax exempt in the Member State of the taxpayer. However, there is no need to tax, under the CFC rules, the profits of permanent establishments which are denied the tax exemption under national rules because these permanent establishments are treated as though they were controlled foreign companies. In order to ensure a higher level of protection, Member States could reduce the control threshold, or employ a higher threshold in comparing the actual corporate tax paid with the corporate tax that would have been charged in the Member State of the taxpayer. Member States could, in transposing CFC rules into their national law, use a sufficiently high tax rate fractional threshold.
It is desirable to address situations both in third countries and within the Union. To comply with the fundamental freedoms, the income categories should be combined with a substance carve-out aimed to limit, within the Union, the impact of the rules to cases where the CFC does not carry on a substantive economic activity. It is important that tax administrations and taxpayers cooperate to gather the relevant facts and circumstances to determine whether the carve-out rule is to apply. It should be acceptable that, in transposing CFC rules into their national law, Member States use white, grey or black lists of third countries, which are compiled on the basis of certain criteria set out in this Directive and may include the corporate tax rate level, or use white lists of Member States compiled on that basis.

(13) Hybrid mismatches are the consequence of differences in the legal characterisation of payments (financial instruments) or entities and those differences surface in the interaction between the legal systems of two jurisdictions. The effect of such mismatches is often a double deduction (i.e. deduction in both states) or a deduction of the income in one state without inclusion in the tax base of the other. To neutralise the effects of hybrid mismatch arrangements, it is necessary to lay down rules whereby one of the two jurisdictions in a mismatch should deny the deduction of a payment leading to such an outcome. In this context, it is useful to clarify that measures aimed to tackle hybrid mismatches in this Directive are aimed to tackle mismatch situations attributable to differences in the legal characterisation of a financial instrument or entity and are not intended to affect the general features of the tax system of a Member State. Although Member States have agreed guidance, in the framework of the Group of the Code of Conduct on Business Taxation, on the tax treatment of hybrid entities and hybrid permanent establishments within the Union as well as on the tax treatment of

hybrid entities in relations with third countries, it is still necessary to enact binding rules. It is critical that further work is undertaken on hybrid mismatches between Member States and third countries, as well as on other hybrid mismatches such as those involving permanent establishments.

(14) It is necessary to clarify that the implementation of the rules against tax avoidance provided in this Directive should not affect the taxpayers' obligation to comply with the arm's length principle or the Member State's right to adjust a tax liability upwards in accordance with the arm's length principle, where applicable.

(15) The European Data Protection Supervisor was consulted in accordance with Article 28(2) of Regulation (EC) No 45/2001 of the European Parliament and of the Council[3]. The right to protection of personal data according to Article 8 of the Charter of Fundamental Rights of the European Union as well as Directive 95/46/EC of the European Parliament and of the Council[4] applies to the processing of personal data carried out within the framework of this Directive.

(16) Considering that a key objective of this Directive is to improve the resilience of the internal market as a whole against cross-border tax avoidance practices, this cannot be sufficiently achieved by the Member States acting individually. National corporate tax systems are disparate and independent action by Member States would only replicate the existing fragmentation of the internal market in direct taxation. It would thus allow inefficiencies and distortions to persist in the interaction of distinct national measures. The result would be lack of coordination. Rather, by reason of the fact that much inefficiency in the internal market primarily gives rise to problems of a cross-border nature, remedial measures should be adopted at Union level. It is therefore critical to adopt solutions that function for the internal market as a whole and this can be better achieved at Union level. Thus, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective. By setting a minimum level of protection for the internal market, this Directive only aims to achieve the essential minimum degree of coordination within the Union for the purpose of materialising its objectives.

(17) The Commission should evaluate the implementation of this Directive four years after its entry into force and report to the Council thereon. Member States should communicate to the Commission all information necessary for this evaluation.

HAS ADOPTED THIS DIRECTIVE:

(**1**) Not yet published in the Official Journal.

(**2**) Not yet published in the Official Journal.

(**3**) Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data (OJ L 8, 12.1.2001, p. 1).

(**4**) Directive 95/46/EC of the European Parliament and the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data (OJ L 281, 23.11.1995, p. 31).