Implementation of the ATAD in the UK and NL

Gijs Fibbe (Baker Tilly / Erasmus University)
Bart Le Blanc (Norton Rose Fulbright)
Andrew Roycroft (Norton Rose Fulbright)

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Under plans announced in the Budget, it is set to come down to 17 per cent by 2020 – which would give the UK the lowest corporation tax rate in the G20.
1. Address the tax challenges of the digital economy
2. Neutralize the effects of hybrid mismatch arrangements
3. Strengthen CFC rules
4. Limit base erosion via interest deductions and other financial payments
5. Counter harmful tax practices, taking into account transparency and substance
6. Prevent treaty abuse
7. Prevent the artificial avoidance of PE status
8. Assure transfer pricing outcomes in line with value creation – intangibles
9. Assure transfer pricing outcomes in line with value creation – risks/capital
10. Assure transfer pricing outcomes in line with value creation – other
11. Establish methodologies to collect and analyze data on BEPS
12. Require taxpayers to disclose their aggressive tax planning arrangements
13. Re-examine transfer pricing documentation
14. Make dispute resolution mechanisms more effective
15. Develop a multilateral instrument

ATAD 1 (Preamble:)
“It is essential for the good functioning of the internal market that Member States implement their commitments under BEPS and more broadly, take action to discourage tax avoidance”
Agenda

1. GAAR & hybrid mismatches
2. Interest deduction from a Dutch & UK perspective
3. CFC from a Dutch & UK perspective

Specific proposed measures:
1. Deductibility of interest
2. Exit taxation
3. Controlled foreign corporation (CFC) rules
4. General anti-abuse rules (GAAR)

- Applicable to all corporate taxpayers in EU
- Minimum standard
- Limited grandfathering rules

Implementation
Entry into effect 1 January 2019 / 1 January 2020
Article 6 ATAD: General Anti-Abuse Rule (GAAR)

For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
ATAD’s GAAR (preamble):

A backstop approach

“… to tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions…”

A balancing act

“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.”
A closer look…

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Article 6 ATAD: General Anti-Abuse Rule (GAAR)

Doesn’t all intra-firm legal structuring have a tax paragraph?

Halifax C-255/02
“taxpayers may choose to structure their business so as to limit their tax liability.”

So what’ll be the outcome of the weighting game?
A closer look…

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What are valid commercial reasons? …and what are invalid commercial reasons?
Identifying ‘abuse’ under ATAD: A balancing act or a slippery slope?

ECJ so far: ‘abuse is *absent* if substance is present’

Although we don’t know what ‘substance’ actually means, at least we do know that substance presence cancels out abuse

ATAD’s GAAR: abuse is *present* despite of substance being present?

Is ‘substance tax planning’ synonymous with ‘aggressive tax planning’?

C-6/16 Eqiom SAS:

“the existence of a purely artificial arrangement which does not reflect economic reality and whose purpose is unduly to obtain a tax advantage.”
Dutch choices re implementation ATAD1 GAAR

Implementation via soft law ‘fraus legis’ developed by Dutch Supreme Court

Only two requirements (no separate artificiality test!):

- The legal actions are set up with the decisive motive to circumvent tax (motive requirement).
- The tax avoidance is contrary to the purpose and scope of the applicable tax act or with a specific provision (norm requirement).

- Fraus legis applies to more taxes not just CIT

Will the domestic anti-abuse doctrine transform into an EU anti-abuse doctrine and change the scope of the existing domestic abuse doctrine?
UK choices re implementation ATAD1 GAAR

UK approach – we already comply:

“The principles of the ”EU GAAR that has been agreed are very similar to existing rules within the UK tax code, both through the legislation for the UK GAAR and well established case law”
UK GAAR and established case law

UK GAAR

- introduced by Finance Act 2013
- the “double reasonableness” test and guidance notes
- the role of the “Advisory Panel” (first decision this year, on employment tax planning)

Established case law:

- “purposive interpretation” (“the Ramsay principle”)
- apply the legislation, construed purposively, to the transaction, viewed realistically
Article 9 ATAD 2 Hybrid Mismatches: the anti-BEPS action (BEPS Action 2)!

Significant extension scope ATAD II compared to scope ATAD I

- **Material**
  - (Reverse) Hybrid entity
  - Hybrid financial instrument
  - Hybrid transfers
  - Hybrid permanent establishment
  - Imported mismatches
  - Dual residents

- **Territorial (third countries)**

  ‘Only’ a minimum rule - Member-States have ‘infinite’ authority to combat hybrids
Dutch choices re implementation anti-mismatch rules

Dutch implementation
- ATAD2 are no part of the current internet consultation proposal
- ATAD2 are consulted in 2018; aim is in force from 1 January 2020

Scope of implementation
- Interaction with the PSD?
- Freedom under treaty (free movement of)?
- Relation with BEPS Action 2?
UK choices re implementation anti-mismatch rules

UK implementation

- UK views the rules as a step in the right direction, but further work required to fully reflect approach taken by OECD
- UK has already replaced the existing anti-hybrid rules (in place since 2005) with rules which are believed to be compliant with BEPS approach to hybrids
- Those new rules have been in force since 1 January 2017
Impact new UK anti-mismatch rules on existing planning structures

Considerations
NL Cooperative BA/WA is classified as tax transparent for UK corporation tax purposes (see HMRC INTM180020/180030).

Loan to NL Cooperative non-existent for UK corporation tax purposes.

Impact UK CFC & Section 259A/B TIOPA 2010
Thanks

Questions?

Dr. G.K. Fibbe
Baker Tilly Berk - Netherlands
E g.fibbe@bakertillyberk.nl
T +31 10 2535900
C +31 6 27109745
## Developing Interest Deduction Limits

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<th>BEPS Action 4 (2015)</th>
<th>ATAD (Article 4)</th>
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<tr>
<td><strong>Goal:</strong></td>
<td>Prevent shifting income to mobile and fungible funding arrangements.</td>
<td>The Directive proposes to limit the amount of net interest that a company can deduct from its taxable income, based on a fixed ratio of its earnings. This should make it less attractive for companies to artificially shift debt in order to minimise their taxes.</td>
</tr>
<tr>
<td><strong>Limit:</strong></td>
<td>Introduce (based on best practises) a fixed ratio rule which limits an entity’s net deductions for interest and equivalent payments to [10%-30%] of EBITDA.</td>
<td>Fixed ratio rule: up to 30% of a taxpayer’s EBITDA. (Art 4, 1). No limit applies to stand-alone entities (art 4. 3(b)).</td>
</tr>
<tr>
<td><strong>Group Escape:</strong></td>
<td>Recommended approach: group ratio rules alongside the fixed ratio rule. Optional 10% uplift to group’s net third party interest expenses allowed. Alternative: equity escape rule.</td>
<td>Interest is fully deductible if taxpayer’s equity over its total assets is equal or higher than the equivalent ratio of the group – where all assets and liabilities are valued using the same method (Art 4, 5).</td>
</tr>
<tr>
<td><strong>De minimis threshold:</strong></td>
<td>Optional amount to carve out entities which have a low level of net interest expenses</td>
<td>EUR 3,000,000 de minimus threshold for the entire group.</td>
</tr>
<tr>
<td><strong>Carry forward:</strong></td>
<td>Reduces impact of earnings volatility, e.g. long term investments that will only generate taxable income in later years.</td>
<td>Member states can choose between three options for carry forward/carry back (Art 4, 6).</td>
</tr>
<tr>
<td><strong>Exclusions:</strong></td>
<td>Optional for highly leveraged specific activities/entities: PPP, banking and insurance sectors.</td>
<td>Loans concluded before 17 June 2016 (and not modified) and loans for long-term public infrastructure projects in the EU. Option to exclude financial undertakings.</td>
</tr>
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German practical experiences

- Rule is largely based on German interest barrier rules:
  - Introduced with effect as of 2008
  - Initially a 1m threshold, increased during financial crisis to 3m
  - Interest and EBITDA-CF subject to coc rules
  - Applies to tax groups, rather than accounting groups (so may need adjustment), if group entities are not in a tax consolidation (Organschaft) they have separate threshold (see below)

- Some practical experiences:
  - De-consolidations (ontvoegingen): Have each stand-alone entity make use of de minimis threshold.
  - Funding structures: ESR apply to cash lending, should not cover operational asset leases or commodity lending.
  - Group ratio: Where different shareholders fund the top holding co with substantial debt, this boosts the group ratio and allows for more deduction at OpCo level.
ESR Implementation in the UK

• New rule introduced, with effect from 1 April 2017
• In addition to existing interest restrictions in the UK (including a modified debt-cap)
• Based on BEPS Action 4
  – Cap: 30% of EBITDA
  – £2m de minimis
  – Can elect for group ratio (if higher)
  – Operation:
    • disallow excess, but carry forward (and ‘reactivate’ in subsequent periods)
    • also, carry forward of unsued interest allowance (max 5 years)
  – Public benefit infrastructure exemption
UK ESR - Example

- 30% of EBITDA
- Net tax-interest expense
- Reactivated interest
- Interest allowance c/f
ESR Implementation in the NL

• New rule: Art 15b CITA announced:
  – Max. 30% of the adjusted tax base (“EBITDA” – tax base plus interest and depreciation) -> exempt income (e.g. dividends) not included.
  – Applies to interest expenses and interest income, including other financing expenses and foreign exchange results.
  – No limits for stand-alone entities, but for taxpayers in an accounting group, with associated (25%) enterprises or with PEs.
  – €3m de minimus threshold per taxpayer.
  – Carry forward but no carry back allowed.
  – No exceptions for financial institutions or infrastructure projects.
  – To be applied as of 1 January 2019 (no extension till 2024).
  – Choices to be made by [a/the] new government:
    • group ratio rule: EBITDA rule, equity escape or no rule at all?
    • Grandfathering for loans prior 17 June 2016?
ESR Implementation in the NL

• Some comments:
  – Will other Dutch interest deduction limitations be cancelled up on introduction of this earnings stripping rule?
  – Will the rule apply to a group of companies that are part of one and the same tax group?
  – What would be the impact of existing case law re the Dutch thin cap rules.
  – If German trends are followed, there will be more stand-alone structures and therefore more compliance work.

• Proposal is more restrictive than ATAD and important choices are not yet made!
• Standard US private equity structure:
  – 5 sub funds invest in a US LLC through a mix of equity and debt (although the majority is generally debt), where each sub fund owns 20% of the US LLC.
  – The LLC is the top holding of its group for US GAAP purposes (even though the LLC is treated as a partnership for US federal tax purposes, as a result of which taxes on the LLC profits are levied/paid at the level of the 5 sub funds).
  – The group consists of several operational entities, including a Dutch Hold Co and a Dutch Op Co.

• Can NL Hold Co apply a group escape (assuming that gets introduced)?
Developing the CFC Concept

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<th>BEPS Action 3 (2015)</th>
<th>ATAD (Article 7 and 8)</th>
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<td><strong>Goal:</strong></td>
<td>Prevent shifting income to a CFC. Rule designed to change taxpayer behaviour.</td>
<td>Multinational companies sometimes shift profits from their parent company in a high tax country to controlled subsidiaries in low or no tax countries, in order to reduce the Group's tax liability. The proposed Controlled Foreign Company (CFC) rule should discourage them from doing this.</td>
</tr>
<tr>
<td><strong>Definition:</strong></td>
<td>Type (corporate entities, transparent entities and permanent establishments); Control (&gt;50%; legal, economic or de facto control: acting in concert)</td>
<td>Applies to “an entity, or a permanent establishment”; &gt;50% (direct or indirect) voting rights, capital or profit share (Art 7.1(a))</td>
</tr>
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<td><strong>Threshold:</strong></td>
<td>Meaningfully lower tax [UK: 75% of local tax; Germany: &lt;25%], possibly combined with black list/white list.</td>
<td>Actual CIT paid by entity or PE &lt; CIT due if entity or PE was subject to parent country tax -/- actual CIT paid by entity or PE. (Art 7.1(b)=50%)</td>
</tr>
<tr>
<td><strong>Counter measure:</strong></td>
<td>Income inclusion using parent country tax rules. Definition left flexible for jurisdictions. Limit use of CFC losses.</td>
<td>Either (Art 7.2(a) non-distributed income from passive income sources or (Art 7.2(b) non-distributed income from non-genuine arrangements.</td>
</tr>
<tr>
<td><strong>No double taxation:</strong></td>
<td>Credit for foreign taxes paid, including WHT. If CFC income was taxed, no subsequent taxation.</td>
<td>Credit for foreign taxes paid (Art 8.7), including WHT. If CFC income was taxed, no subsequent taxation (Art 8.5+6).</td>
</tr>
<tr>
<td><strong>Exclusions:</strong></td>
<td>-</td>
<td>Optional: &lt;1/3 passive income (Art 7.3+4).</td>
</tr>
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CFC Implementation in the UK

• Extensive changes made to UK CFC regime in 2012
• Recast, to counter artificial diversion of profits (reflecting move to territorial system)
• Not expected to be material changes:
  “The Agreement reached on EU rules for CFCs is in line with the BEPS output and covers the approach taken in the UK’s current CFC rules…”
CFC Implementation in the UK

- Income profits only (separate rules for capital gains)
- Tests of ‘control’
- Only taxes profits which pass through on the relevant gateway:
  - General business profits
  - Non-trading finance profits
  - Trading finance profits
  - Captive insurance business profits
  - Solo consolidation profits (certain banks)
CFC Implementation in the UK

• Safe harbours for certain types of profit (eg, business profits)

• Exclusions and exemptions
  – For minor UK activities, net economic value from overseas activities etc
  – Finance company exemptions
  – Exempt period, excluded territory and low profits exemptions
CFC Implementation in the NL

• Currently, participation exemption:
  – No exemption for passive, low-taxed subsidiaries (>5%).
  – “Low taxed”: Subs taxable income is subject to a profit tax that according to Dutch standards results in a realistic taxation, i.e. generally an effective rate of at least 10%.
  – “Passive”: Generally less than 50% of the value of its assets (and the assets of its lower-tier subsidiaries, on a quasi-consolidated basis) consists of “passive” (low-taxed, portfolio) investments
  – Annual mark-to-market for >25% subs with >90% passive assets.

• Same mechanism for passive PEs
• But CFC is different…
CFC Implementation in the NL

• New rule: Art 15ba CITA announced:
  – Non-distributed profits of a CFC relating to certain passive types of income (interest, royalties, dividends, rent, insurance premiums and re-invoiced products and services) – Model (a).
  – Control: >50% capital, vote or profits.
  – Low taxed: no tax levied that is reasonable according to Dutch standards. At least half of the tax that would be due if entity was Dutch.

• No CFC if (i) profits arise >50% from non-passive types of income (ii) regulated financial enterprises or (iii) real economic activities that use personnel, equipment, assets and real estate.
CFC Implementation in the NL

• Some comments:
  – Model (a) potentially results in double taxation – not relief available.
  – Practical: Check activities and deemed Dutch tax burden of all direct and indirect subs.
  – A CFC can benefit from participation exemption – how would that work?
Example – Dutch CFC Rule

- NL HoldCo owns 100% of CFC Co and No CFC Co. CFC Co provides loan from equity to No CFC Co.
- CFC is taxed at 11%, so generally meets conditions for participation exemption but may not avoid CFC rule.
- FY 2020: CFC Co receives “passive” interest received of 1,000. NL HoldCo should report 1,000 as CFC income, tax is at 25% and allow for 11% credit.
- FY 2021: dividend of 1,000 to NL HoldCo. Dividend received by NL HoldCo is exempt (both under Art 13 and under art [28]).
  1. *Is this double taxation and should ATAD prevent this (Art 8,1)?*
  2. *What if there is a WHT on interest paid by No CFC Co?*
  3. *What if NL HoldCo owns only 50% (or less of No CFC Co?*