**LEGAL INFORMATIVE NEWSLETTER**

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest. We would welcome any comment you might have.

## THE REVISED PARENT SUBSIDIARY EU DIRECTIVE – GENERAL ANTI AVOIDANCE RULES, REGULATORY ASPECTS AND THE UNDERLYING OBJECTIVES

**(I) INTRODUCTION -** On 27 January 2015, the European Council amended the EU's parent-subsidiary directive, adding a binding anti-abuse clause to prevent tax avoidance and aggressive tax planning by corporate groups.

The aim is to stop the parent-subsidiary directive from being misused for the purposes of tax avoidance, and to achieve greater consistency in its application in different member states.

The anti-abuse clause will prevent member states from granting the benefits of the directive to arrangements that are not "genuine", i.e. that have been put into place to obtain a tax advantage without reflecting economic reality.

The clause is formulated as a "de minimis" rule, meaning that member states can apply stricter national rules, as long as they meet minimum EU requirements.

**AMENDMENTS TO THE DIRECTIVE -** The Parent Subsidiary Directive (2011/96/EU), adopted in November 2011, is intended to ensure that profits made by cross-border groups are not taxed twice.

It requires member states to exempt from taxation profits received by parent companies from their subsidiaries in other member states.

In November 2013, the Commission proposed to amend the directive with the twofold objective of tackling hybrid loan mismatches and introducing a general anti-abuse rule.

In May 2014, the Council decided to split the proposal and to address these two issues separately.

In July 2014, it adopted as a first step provisions to prevent corporate groups from using hybrid loan arrangements to benefit from double-non taxation under the directive.

Meanwhile work continued on the anti-abuse clause, and agreement was reached in December 2014.

This agreement is designed to prevent taxpayers from artificially bringing themselves within the scope of the Directive's application and so abusing it.

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**HYBRID LOAN ARRANGEMENTS -** On the matter of preventing double non-taxation derived from hybrid loan arrangements, the aim of the amendment to the parent-subsidiary directive is to prevent cross-border companies from planning their intra-group payments so as to result in double non-taxation where hybrid loan arrangements are involved.

The Member State of the parent company will henceforth refrain from taxing profits from the subsidiary only to the extent that such profits are not tax deductible for the subsidiary.

Such tax planning was not ruled out before, as the provisions of the original parent subsidiary directive required member states to exempt from taxation the profits that parent companies received from their subsidiaries in other member states.

The intention was to ensure that profits were not taxed twice, and that cross-border groups were thereby not put at a disadvantage compared to domestic groups.

However, hybrid loan arrangements enabled cross-border groups to avoid paying taxes altogether by exploiting mismatches between national tax rules. In such cases, the received distributed profits were not taxable in the member state of the parent company, whilst they were treated as a tax-deductible expense in the member state of the subsidiary.

The amendment adopted is meant to help increase member states' tax revenues, and help create a level playing field between groups with parent companies and subsidiaries located in different countries and those that have all entities based in a single member state.

The amendment is part of a broader proposal that the Council agreed to split in order to allow early adoption of the new rule on hybrid loans, whilst enabling work to continue on another aspect, namely the introduction of a common anti-abuse provision.

**DEADLINE FOR THE MEMBER STATES -** Member States had until 31 December 2015 to introduce an anti-abuse rule into national law. The same deadline applies for transposition of the July 2014 amendments to tackle hybrid loan mismatches.

**WORKS IN THE OECD** – The issue of corporate tax avoidance is a high political priority both at EU level and internationally. The OECD's work on base erosion and profit shifting - BEPS has been endorsed as the way forward at recent G20 and G8 meetings.

In December 2014, the European Council highlighted "*an urgent need to advance efforts in the fight against tax avoidance and aggressive tax planning, both at the global and EU levels*".

**THE AMENDMENTS -** Coming to the text of the Directive, its Article 1 sets out that in Directive 2011/96/EU, Article 1(2) is replaced by the following paragraphs:

“2. Member States shall not grant the benefits of this Directive to 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 this Directive, are not genuine having regard to all relevant facts and circumstances.

An arrangement may comprise more than one step or part.

3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid

commercial reasons which reflect economic reality.

4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse."

Article 2 set forth instead that Member States had to bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 December 2015 at the latest.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

**HOW TO COPE WITH THESE NEW CONCEPTS** - General Anti Avoidance Rules - GAAR and other anti-avoidance approaches frequently utilize subjective criteria, often looking beyond the form of a transaction to its underlying substance, purpose or intent.

As a result, there is often a close connection between developments with respect to GAAR and developments in the courts, with litigation arising over the application of GAAR provisions and pre-GAAR litigation experience often one of the driving forces for enactment of such provisions.

The number of controversies litigated based on GAAR or similar arguments is on the rise around the world, sometimes involving the first court tests of long-established but rarely used or challenged statutes.

This exemplifies the issue in regard to the Parent Subsidiary Directive GAAR. As noted in the introduction to this report, the text of the Directive GAAR provides no guidance on how national governments should interpret it.

This may give rise to a protracted period of uncertainty for business, as tax authorities and taxpayers alike struggle to identify what constitutes a "main purpose or one of the main purposes" or "valid commercial reasons."

While no specific jurisprudence exists, the guiding principles that underpin EU case law provide some guidance in relation to the concept of "valid commercial reasons" in particular.

In the Cadbury Schweppes case, an actual establishment intended to carry on genuine economic activities that physically exist in terms of premises, staff and equipment ("substance") implies sufficient economic reality.

In Somafer, this may be the case if an adequate staff is available which performs the functions relevant to the management activities carried out, while a direct or indirect involvement in the management of the company in which the holding has been acquired may also qualify (Cassa di Risparmio di Firenze and others).

**CONCLUSIONS** - How a corporation manages GAAR typically depends on its own overall risk propension. That is the level of risk the corporation is willing to accept in a transaction.

That risk propension is to be decided at the board level, and it determines the manner in which transactions are planned and executed. Leading practice in this area is for the corporation to operate under a tax corporate governance framework that includes a documented process for significant transaction sign-off. This framework should outline the process for transactions that are material or that have particular characteristics that may attract tax authority scrutiny.

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