CFE's Tax Top 5

Key tax news of the week

27 February 2017

1. Council of the EU reaches deal on ATAD2, European Commission welcomes agreement that fights BEPS (hybrid mismatches) involving non-EU countries

On 21 February 2017, the Council of the EU reached agreement on the finalised text of the Directive extending the scope of the original Anti-Tax Avoidance Directive ("ATAD"). The "ATAD 2" Directive will extend the scope of the ATAD to include hybrid mismatches involving third countries (non-EU Member States) and will tackle specific hybrid scenarios, for example those relating to permanent establishments ("PE"), dual resident entities and hybrid financial instruments. The ATAD has an implementation deadline of 31 December 2018 whereas ATAD 2 will for the most part have a deadline of 31 December 2019, and up until 21 December 2021 for certain aspects (i.e. reverse hybrids). The European Parliament must now issue an Opinion after which the Council of the EU will adopt the Directive.

Pursuant to the finalised text, a hybrid mismatch will not arise where the payer jurisdiction under an "on-market hybrid transfer" requires a financial trader to include all amounts received under the transferred financial instrument as income. Therefore, a hybrid mismatch will only arise to the extent that the payer jurisdiction allows the deduction to be set-off against an amount that is not dual-inclusion income. Finally, payments made by a financial trader will not be considered to be hybrid payments under the Directive unless they arise in the context of associated enterprises, between a taxpayer and an associated enterprise, between the head office and PE, between two or more PEs of the same entity, or under a structured agreement.

In the context of reverse hybrid mismatches which arise when the hybrid entity is located in a Member State, the reverse hybrid entity will be regarded as tax resident in that Member State and taxed on the income that is not otherwise subject to tax. The reverse hybrid provisions will not apply to recognised collective investment vehicles.

In order to avoid any unintended consequences between the hybrid financial instrument and the loss-absorbing requirements imposed on banks, Member States will be allowed to provide an exemption for intra-group instruments that have been issued with the sole purpose of meeting the issuer's loss-absorbing capacity requirements. The carve-out will not apply if it arises under a structured arrangement or is done for the purpose of avoiding tax. This carve-out will be limited in time until 31 December 2022 and the Commission will present a report assessing the consequences.

2. Council of the EU to finalise by end of year the 'blacklist' of non-cooperative jurisdictions for tax purposes

The Council of EU sitting as ECOFIN also discussed on 21 February 2017 the EU list of non-cooperative jurisdictions for tax purposes. The Council agreed to establish a final list of non-cooperative jurisdictions by the end of 2017. An agreement has also been reached on the scope of the application of the Criterion 2.2., as established by the Council in its criteria and process leading to the establishment of the EU list of 8 November 2016. Criterion 2.2. establishes that "a jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect economic activity in the jurisdiction." The 8 November 2016 Council conclusions lay down the tax good governance criteria that should be used to screen jurisdictions, and, establish guidelines for the screening. The established criteria are related to tax transparency, fair taxation and implementation of anti-BEPS measures.

The establishment of EU 'blacklist' of non-cooperative jurisdictions is a follow-up of the Panama Papers revelations. European Union's actions are taken in line with the OECD work in the Global Forum on tax transparency and exchange of information for tax purposes.

The Council also discussed the work of the Code of Conduct group responsible for implementation of the EU Code of conduct on business taxation, and a body that shall oversee the screening process leading to establishment of the EU 'blacklist' of non-cooperative jurisdictions for tax purposes.

3. **European Parliament proposes extended scope of EU's public country-by-country reporting**

Under the draft Report of the European Parliament on the Directive 2013/34/EU on public by country reporting, the threshold for the multinational companies caught under these proposed EU rules would be set at EUR 40 million as opposed to the originally envisaged threshold of EUR 750 million consolidated net turnover.

The European Parliament's draft Report of its Committees on Economic and Monetary Affairs ('ECON') and Committee of Legal Affairs aims to require from multinational corporations to disclose relevant information for all countries worldwide in which they operate, so that taxes would be paid where the profits are generated. According to the draft Report, the proposal of non-aggregated data to be disclosed is in line with the EU's policy at helping developing countries to consolidate their tax revenues.

Under the proposed amendments, the EU Member States shall require subsidiaries incorporated in EU Member states and controlled by an ultimate parent undertaking which has a consolidated net turnover exceeding EUR 40 000 000 (which is not governed by the law of an EU Member State), to publish the report on income tax information of that ultimate parent undertaking on an annual basis.

The Parliament's Report proposes that the corporate tax information is published in a common template available in an open data format and made accessible to the public on the website of the subsidiary undertaking or on the website of an affiliated undertaking in at least one of the official languages of the Union. On the same date, the company should also file the report in a public registry managed by the European Commission.

These amendments come in a form of draft European Parliament legislative resolution (first reading-ordinary legislative procedure), on the proposal for a directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches.

4. Court of Justice of the EU published 'Apple' appeal in the Ireland State aid case

The Court of Justice of the European Union ("CJEU") published the main arguments and pleas in law of Apple's action for annulment of European Commission Decision of 30 August 2016 on State aid to Apple [Apple Sales International ("ASI") and Apple Operations Europe ("AOE"), herein forth "Apple" or the applicant] implemented by Ireland.

Apple's main arguments are based on maintaining error in law by the European Commission in the interpretation of Irish tax law and EU State aid rules.

At the outset, Apple claims that there is no legal requirement under Section 25 Taxes Consolidated Act ("TCA 1997") that profit allocation to branches is compliant with the arm's length principle ('ALP'). Such a requirement does not exist under European law either, the applicant claims, adding that the ALP is not applicable standard of assessment under Article 107(1) TFEU, the relevant provision of EU law that prohibits unauthorised State aid.

In relation to the development and commercial utilisation of Apple's intellectual property rights ("IP"), Apple claims that the European Commission disregard the fact the Apple's IP is developed, controlled and managed in California, United States, and not in Ireland. IP related profits should therefore be subject to tax in the United States.

Apples further argues that the Commission failed to accept the branches in Ireland performed routine operations only and therefore were limited in its activates and commercial utilisation of IP. The applicant points to Commission's alleged misunderstanding of the fact that the Irish branches did not play significant part in the critical profit making activities of the group.

The applicant claims that the European Commission failed to establish 'selectivity', which is a decisive State aid criterion. Apple was treated by the Irish Revenue in the same way as the other non-resident entities for tax purposes, and the Commission wrongly assumed that Apple is an Irish resident entity for tax purposes.

In respect of the transfer-pricing methodology involved, Apple claims that the Commission erred in law and fact by the choice and application of the Transactional Net Margin Method ("TNMM"). TNMM is a transfer pricing method that compares the net profit margin arising from a non-arm's length transaction with the net profit margins reached in similar arm's length transactions, and, then examines the net profit margin relative to an appropriate base such as costs, sales or assets. According to Apple, the subsidiary line of the Commission fails to articulate a correct profit attribution analysis.

Finally, Apple claims that the European Commission breached the principles of legal certainty and non-retroactivity by demanding recovery of the State aid, and that the European Commission decision exceeds Commission's competence under Article 107(1) TFEU.

5. CFE Forum 2017: "Do you have a taxable presence in a country? The New Reality Permanent and Fixed (VAT) Establishments in the Post-BEPS World"

CFE Forum 2017, our annual international tax conference, will take place **on 30 March 2017, 9:00 to 16:30, in Brussels (***Rue Montoyer 47, B- 1000 Brussels). For programme and registration details, please follow the links below:*

Programme: Link

Further information: CFE website.

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The selection of the remitted material has been prepared by
Piergiorgio Valente / Aleksandar Ivanovski / Mary Dineen / Filipa Correia

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