European Commission
Taxation and Customs Union

Workshop on the Common Consolidated Corporate Tax Base

Anti-Abuse Rules in the CCCTB

20 October 2010

Introduction

CCCTB anti-abuse shield is structured at 2 levels:

- **General Anti-Avoidance Rule** (**GAAR**);
- The following **specific rules**:

1. Disallowance of third-country source interest deduction;
2. Switch-over from a tax exemption of foreign income to relief by credit;
3. Controlled Foreign Company (CFC) legislation;
4. Disallowance of the participation exemption in share disposals;
5. Rules to avoid a manipulation of the asset factor;
6. Rules to tackle double deductions in the so-called 'sandwich cases‛.

The GAAR (i)

- Transaction (or series of transactions) carried out for the **sole purpose of avoiding taxation**;
- Target: practices **without economic substance** – ‘wholly artificial arrangements’;
- Outcome: to **ignore** the artificial steps (i.e. one or more transactions).
- Escape clause: possibility for the taxpayer to provide **commercial justification** for its activity. If tax planning incorporates elements of genuine conduct of trade, it is legitimate regardless of whether the scheme is designed to mitigate tax.

The GAAR (ii)

- Possible drafting proposal:

- *Where a transaction or series of transactions are carried out for the sole purpose of avoiding taxation, they shall be ignored for the purposes of calculating the tax base. This provision shall not apply to genuine commercial activities where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts.*

Disallowance of Interest Deduction (i)

- Provision is meant to achieve the effects of Thin Capitalisation;
- Conditions for application:

  (i) Interest is paid to an **associated enterprise**;

  (ii) Associated enterprise is resident in a **third country** which applies :

  - a **statutory CIT rate at lower than 40%** of the EU **average**; or

  - a **substantially lower level of tax on the basis of a special regime**;

  (iii) There is **no exchange of information** on request to the standard of the Mutual Assistance Directive.
- The rule is meant to cover not only cases of "definitive influence and control" (Freedom of Establishment) but also extends to Free Movement of Capital;

Disallowance of Interest Deduction (ii)

- **Escape clause** – Interest will still be deductible if:

  (i) The payer has included income of the payee in its tax base under CFC rules and only up to that amount;

  (ii) The payee’s principal class of shares is regularly traded in a recognised stock exchange;

  (iii) The payee proves its engagement in the active conduct of trade or business at residence.

Switch-Over Clause

- **Exception** to the general rule of exempting inbound profit distributions, proceeds from share disposals and income earned from a third-country located PE;
- These – otherwise exempt - **inflows are made taxable** (and **credit** is given for tax already paid at source);
- **Aim:** to discourage inflow of revenues through low-tax third countries;
- **Low-tax third country:** operates, under its general tax regime, a statutory corporate tax rate lower than 40% of the average statutory corporate tax rate in the EU or a special regime allowing for substantially lower tax than its general regime.

CFC Legislation (i)

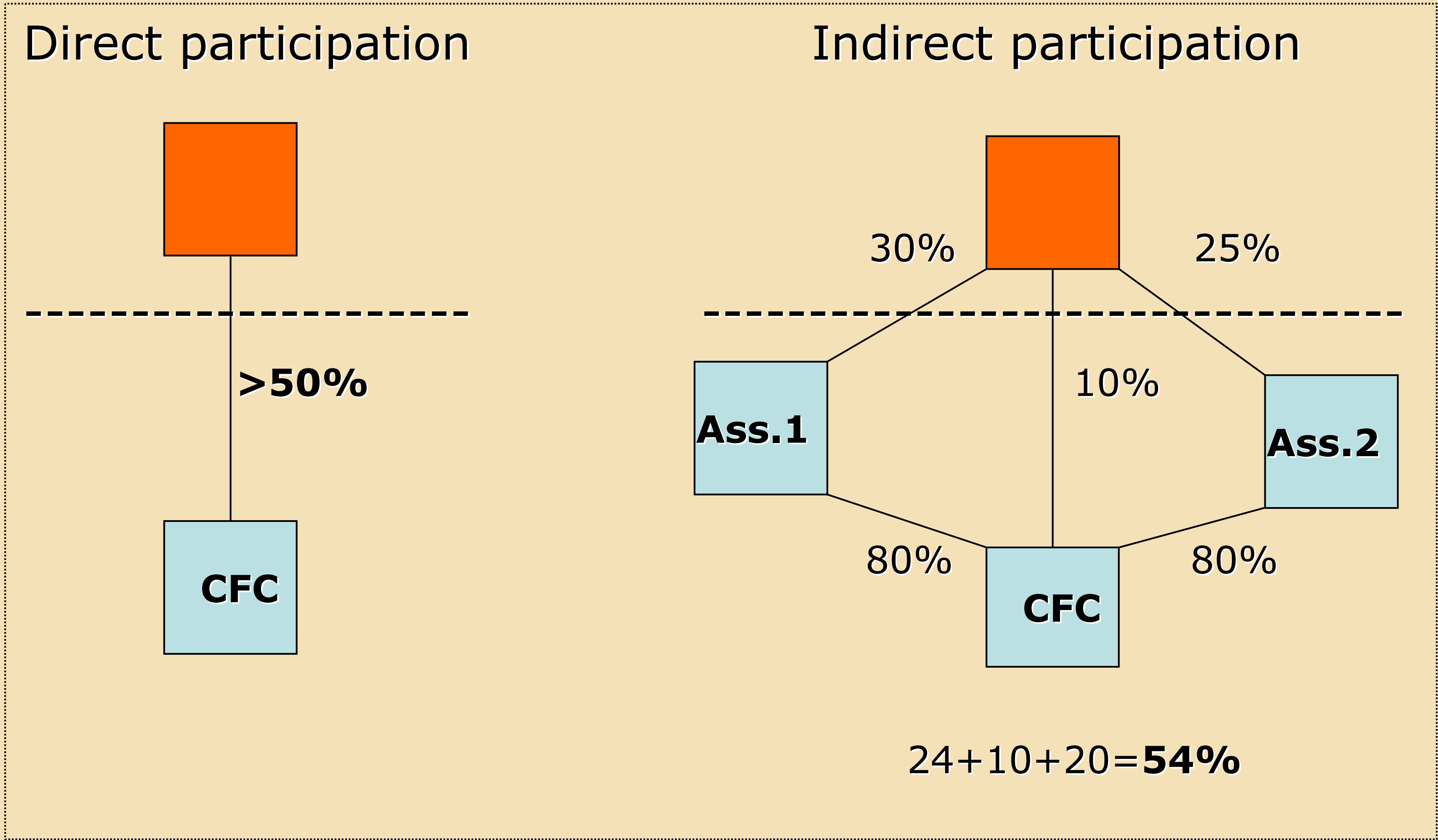
Requirements for applying CFC legislation:

(a) A company applying CCCTB rules,

by itself or together with its associated enterprises, must

- control more than 50% of the voting rights;
- own more than 50% of the capital; and
- be entitled to receive more than 50% of the profit.

CFC Legislation (ii)



CFC Legislation (iii)

(b) The CFC is tax resident in a ***low-tax*** **third country***, meaning a country which operates:

- under its general tax regime, a **statutory** corporate tax rate **lower than 40%** of the average **statutory** corporate tax **rate** in the Member States; or

- a **special regime** allowing for a **substantially lower** level of **taxation** than the general regime.

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* EEA countries which exchange information to the standard of the Mutual Assistance Directive are excluded from the scope of this rule.

CFC Legislation (iv)

(c) More than **30%** of the income accruing to the CFC is **'tainted'** – the concept is defined by reference to the following 2 tests:

- **type of income;** interest or any other income generated by financial assets, royalties or other IP-generated income, dividends, income from disposals of shares, (generally) movable property, immovable property, insurance, banking and other financial activities.

- **more than 50%** of the income must be derived from transactions between the CFC and the taxpayer (or its associated enterprises).

CFC Legislation (v)

(d) **Escape clause:** if the CFC's principal class of shares is regularly traded on a recognised stock exchange.

- All undistributed income of the CFC will be taxable **without distinction** between active and passive income;
- ***In proportion to the profit entitlement*** of the taxpayer.
- **If a CFC is loss-making**, the losses will not be incorporated in the tax base of the taxpayer but the CFC will be entitled to **carry forward the losses** for future years.

Interaction between CFC rules and the Switch-Over Clause

To prevent double taxation, the method for relief does not switch over to credit –

So, **tax exemption** continues to apply to amounts of income already taxed under CFC rules:

- **dividend distributions** by the CFC up to the extent that the profit corresponds to income already been taxed under CFC rules;
- the proceeds from **disposals of shares** in the CFC up to the amount of undistributed income already been taxed under CFC rules.

Disallowance of the participation exemption in share disposals

- **Disposals of shares** resulting in a taxpayer leaving the group are **tax free**.
- This tax exemption is **disallowed** if the leaving taxpayer acquired, by an intra-group transfer, fixed assets during the current or previous tax year.
- **Aim:** to discourage moves of assets to a specific taxpayer for the sole purpose of taking them out of the group through a tax-free disposal of shares rather than a taxable sale of assets.
- Participation exemption is **retained** if it is proved that the intra-group transaction was done **for valid commercial reasons.**

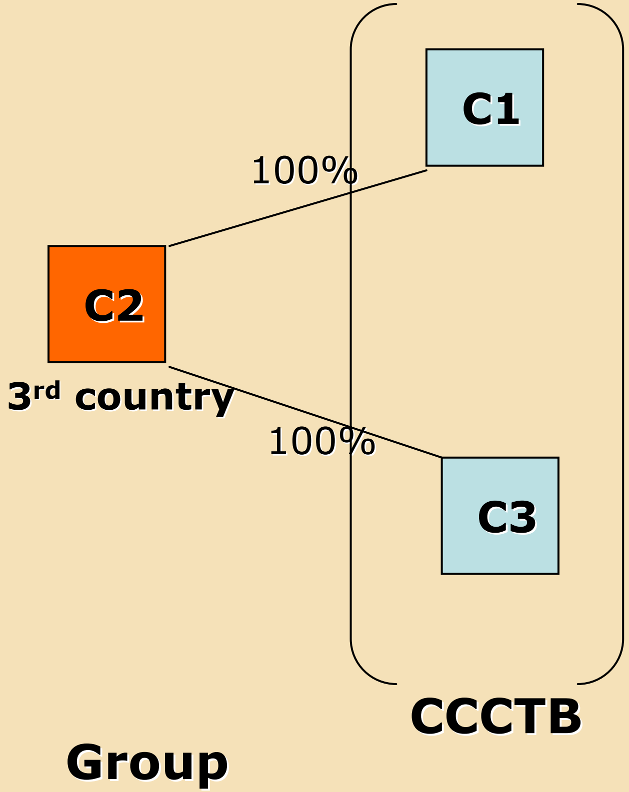
Rules to avoid a manipulation of the asset factor

- If an asset is sold outside the group following an intra-group transfer during the current or previous tax year, the asset is **deemed to have always remained with the group member which held it prior to the intra-group transfer.**
- **Effect:** the share of the 'departing' MS is protected.
- **Aim:** to prevent a manipulation of the asset factor.
- This adjustment is prevented if it is proved that the intra-group transaction was done **for valid commercial reasons.**

The 'Sandwich Case'

- **Rule:** C1 & C3 are eligible to form a group only if C2 is located in a third country which exchanges information;

- **Aim:** to prevent double deductions within the group.



Conclusion

Questions raised in the paper:

1. What are your views of the GAAR?
2. What are your views of the suggested rule on the limitation to interest deduction? Is it a sufficient replacement of Thin Capitalisation rules?
3. Do you have any comments on a possible switch-over clause?
4. What are your views of the suggested CFC rules?
5. What do you think of the disallowance of the participation exemption in certain disposals of shares and of the rules against the manipulation of the asset factor?
6. What about the exchange of information requirement for being entitled to consolidate in ‘sandwich cases’?