EU PARENT: SUBSIDIARY DIRECTIVE

The initiatives against tax evasion
International tax policy has in the past been focused on the lifting tax obstacles to trade, in particular the avoidance of double taxation. In recent years we have seen a new development in international taxation being promoted by the EU and also at a global level by the G20: rules designed to ensure that individual countries are able to enforce their domestic tax rules in an international context and the fighting double non taxation. The OECD is, at global level, the champion of this initiative at the request of G20. the drive is for a global standard for automatic exchange of information and on base erosion and profit shifting.

The European union is leading the way with an unprecedented barrage of legislation. On 6 December 2012 the Commission adopted a very ambitious Action Plan in order to give a more effective European response to tax fraud, evasion or avoidance.

Since the adoption of the Action Plan, the Commission has tabled a number of proposals in a number of areas:

- the expansion of automatic exchange of information;
- intensifying the fight against VAT fraud;
- monitoring international tax good governance;
- launch the debate on digital taxation and
- easing VAT compliance.

The EU's maintains that each year large amounts of money are lost due to tax fraud and evasion. At a time of increasing government spending and mounting budgetary constraints, the argument is that this loss of revenue for government is a threat to fair taxation and fair competition in the single market. This is all well and good assuming responsible and accountable public governance by governments.

Changes to the Parent-Subsidiary Directive
The latest target of the Action Plan is the revision of the Parent-Subsidiary Directive (PSD) approved by EU Finance Ministers in June 2014.

The PSD was originally conceived in 1990 in order to prevent same-group companies based in different Member States, such as a parent company and a subsidiary, from being taxed twice on the same income. To do so, the Directive gives a tax exemption for dividends and other profit distributions paid by subsidiary companies to their parent company.

It is claimed that in an increasing number of cases, the Directive is being abused with the objective to avoid paying taxes in any Member State (double non-taxation). This is apparently done by the use of particular tax planning technique called ‘hybrid loan arrangement’. The purpose of the revision of the Directive is to legislate against this possibility and to ensure that all businesses pay their fair share of taxes. There are two proposed changes to the Directive which Member States must adopt by 31 December 2015.

Hybrid loan arrangement are financial instruments that have the characteristics of both debt and equity and as a result may be subject to different tax treatment in different Member States. A cross border hybrid loans may be treated as debt (ie, a tax deductible expense) in the Member State of the subsidiary and as a tax exempted dividend in the Member State of the parent company. This is of course not the desired outcome and goes against the spirit of the regulations. This results in a deduction in one Member State followed by tax exemption in the other.

The proposed amendment stipulates that the Member State in which the parent company resides, would not grant the tax exemption.

Secondly, it is proposed that General Anti-Abuse Rule (GAAR) be implemented by the Member States in order to generally block off tax avoidance strategies. Let's us for example take the case of a parent company outside the EU that has a subsidiary operating in a Member State that levies withholding taxes on dividend payments. The parent could, under current regulations, set up an intermediary company in another member state which would not charge withholding taxes. The subsidiary can then avoid the withholding tax by channelling its profits through the intermediary towards the parent company. Harmonising Member States GAAR will ensure that Member States have a common approach in not allowing tax planning of this nature.

The Commission is here treading on dangerous ground limiting one of the EU's fundamental freedoms which is that of Freedom of Establishment. Also importantly such a proposal erodes the right of individuals and entities to organise their affairs in ways that legally minimise the tax burden which is now fast becoming the new serious obstacle to international trade.

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