The new PSD general anti-abuse rule

SPEED READ The Parent-Subsidiary Directive’s new anti-abuse clause has been adopted to curtail tax avoidance and aggressive tax planning by corporate groups. Member states have until 31 December 2015 to implement the new provision. The impact of the new anti-abuse provision will be felt in varying degrees across member states. The UK, with its no-WHT policy on outbound dividends and stricter anti-abuse rules on inbound dividends, will be little affected by this new EU provision.

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On 27 January 2015, the EU Council adopted Directive 2015/121, a proposal of the European Commission to amend the Parent-Subsidiary Directive 2011/96/EU (“the PSD”) to include a general anti-abuse rule (“the EU GAAR”) into the existing directive. The amendment is aimed at preventing taxpayers from gaining the benefits of the PSD through the use of artificial arrangements which do not reflect economic reality.

The EU GAAR represents one element of a wider Commission campaign to tackle tax avoidance and to shift the focus of anti-avoidance policy to the supranational level. The effects of the EU GAAR will be felt in varying degrees across member states, and indeed may have a very limited impact where stringent anti-avoidance measures are already in place, including the UK. However, the new provision can be seen as an indication of the Commission’s wider objectives. The Commission hopes that by coordinating measures across the EU, taxpayers will find it increasingly difficult to exploit mismatches in domestic rules so as to reduce or eliminate their tax bills.

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Background
The PSD was originally issued in 1990 as Directive 90/435/EEC; since then it has been amended several times and was recast in 2011 as Directive 2011/96/EU. It concerns the tax treatment of profit distributions between parent companies and subsidiaries of different member states. The purpose of the PSD is to create a common system of taxation applicable to distributions between such parent companies and subsidiaries by:
- exempting cross-border distribution of profits from withholding tax in the state of residence of the subsidiary (PSD art 5); and
- eliminating double taxation in the state of residence of the parent company by either exempting the profits distributed or granting a credit for the tax paid by the subsidiary on the underlying profits (PSD arts 4 and 6).

The previous anti-avoidance provision, contained in art 1(2) of Directive 2011/96/EU, allowed the application of domestic and arrangement based provisions aimed at preventing fraud and abuse. Despite such domestic and/or treaty based anti-abuse provisions, ‘directive shopping’ arrangements have been designed to misuse the PSD and allow dividends double non-taxation (see figure 1, pre EU GAAR).

In 2013, the Commission presented a proposal to amend the PSD to prevent it from being misused for the purpose of tax avoidance. The proposal had two objectives:
- to tackle double non-taxation that results from hybrid loan mismatches; and
- to introduce a general anti-abuse rule to prevent the misuse of the PSD and ensure a greater consistency in its application among member states.

The European Council adopted the first proposal on 20 June 2014 and the second on 27 January 2015. Member states have until 31 December 2015 to implement these two amendments.

The second proposal (the EU GAAR), which replaced art 1(2), is designed to prevent taxpayers from artificially bringing themselves within the scope of the Directive’s application and so abusing it. When first proposed in 2013, some member states were concerned that an EU GAAR may actually hamper their efforts to tackle abuse by removing their ability to impose (often stricter) domestic anti-avoidance measures. These fears should now be allayed as the EU GAAR is framed as a de minimis rule and allows member states to impose their own more stringent measures; see art 1(3).

The new provision
The EU GAAR consists of two elements:
- a main purpose test; and
- a lack of economic reality test.

The purpose of the EU GAAR is to tackle arrangements that fail to meet both tests (see figure 1, post EU GAAR). It requires member states to refrain from granting the benefits of the PSD (withholding tax exemption) if:
- the main purpose or one of the main purposes is to obtain a tax advantage that would defeat the object and purpose of the PSD; and
- the arrangements are not genuine having regard to all relevant facts and circumstances.

An arrangement or series of arrangements will be deemed not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality (art 1(3)). The EU GAAR appears to apply not only to the arrangement as a whole but also to the intermediate steps that make up such an arrangement.
UK legislation

The UK is a jurisdiction often used for the location of holding companies because, inter alia, it is a member state of the EU and benefits from the PSD and it has an extensive network of double tax conventions (DTCs). Under existing UK tax legislation, no withholding tax is applied to outbound dividends. This satisfies the requirement of art 5 of the PSD. If a subsidiary is incorporated in an EU member state (other than the UK) and if the PSD applies, dividends paid to a UK holding company will not suffer any withholding tax in the country of distribution (i.e. country where the subsidiary is incorporated). Thus, potentially the UK holding company can further distribute such dividends onwards to non-EU countries without a charge to tax. As the UK is mostly used as a ‘passing-through’ jurisdiction in this way, the EU GAAR will have to be applied by the country of distribution of the profits (EU MS 1) and not by the UK (see figure 2, outbound). The tax treatment of the dividend in the hands of the recipient company is then obviously dependent on the tax regime in that particular jurisdiction. Therefore, the EU GAAR will have no impact on UK outbound dividend distributions.

Inbound dividend distributions into the UK are however governed by domestic anti-abuse rules. Under the company distribution rules found in CTA 2009 Part 9A, UK and non-UK sourced dividends paid to UK companies are subject to corporation tax unless the distribution falls within a number of exemptions. Broadly, exemption from tax will be denied if the dividend is paid as part of a tax advantage scheme, which is a scheme the main purpose (or one of the main purposes) of which is to obtain a tax advantage or to fall within one of the exemptions. In other words, dividends received by UK companies from domestic or foreign subsidiaries are exempt. Therefore, arts 4 and 6 of the PSD are satisfied, unless the distribution has as its purpose (or one of the main purposes) obtaining a tax advantage, in which case the exemptions are disapplied (see figure 2, inbound). The overall effect of this legislation is that the UK exempts incoming dividends from CT, except where a tax avoidance scheme/motive is involved. This appears to be in line with the object and purpose of the PSD.

UK action

One assumes that the reframed PSD with its GAAR does not positively require a member state to impose a tax charge that it does not currently have. In respect of outgoing dividends, the UK does not need to take any action because the benefits of the PSD are not granted anyway to outbound dividends (i.e. all outbound dividends are exempt from withholding tax per se). Also, no action is necessary in respect of incoming dividends because the practical effect of CTA 2009 Part 9A is that UK already has a more generous anti-avoidance regime than the de minimis rule provided for in art 1(2) of the PSD. Consequently, it is hard to see what action the UK will have to take.

Going forward and the Commission’s objectives

The EU GAAR is part of the Commission’s broad agenda to tackle corporate tax avoidance, which originated in its 2012 paper An action plan to strengthen the fight against tax fraud and tax evasion. The Commission believes that tax avoidance deprives member states of ‘billions of euros a year’, in addition to undermining fair competition and fair burden-sharing of tax.

The application of the EU GAAR is clearly
limited in scope, being mandatory in application only to the PSD, and merely underpinning domestic regimes that already have stringent rules in place, such as the UK. It is, however, indicative of things to come. Despite the reservations of various member states and business representatives during consultation on the EU GAAR in 2013, it seems as though the Commission is determined to push ahead and address tax avoidance on a cross-border, supranational basis.

The Commission highlighted in its EU GAAR Impact assessment that unilateral measures to tackle corporate tax avoidance will always fall short, as the very existence of discrepancies between domestic regimes make them open to abuse. The Commission has already made progress in supporting the EU GAAR with related anti-avoidance proposals, and has stated its intention to integrate new OECD/G20 BEPS initiatives at EU level.

The Commission is clearly aware that the effectiveness of any general anti-avoidance rule is intrinsically linked to the ability of tax authorities to obtain the necessary information to identify abusive arrangements. The effectiveness of the EU GAAR will therefore be dependent on the success of complementary Commission proposals introduced to expose and combat corporate tax avoidance. By way of example, on 18 March 2015 the Commission announced a tax transparency package which included, inter alia, a proposal for automatic exchange of information by member states on their cross-border tax rulings. Issuing tax rulings is not contrary to EU law and they can be a useful tool in providing legal certainty to businesses wishing to set up large or complex corporate structures for genuine economic reasons. Tax rulings may, however, encourage companies to enter into artificial arrangements so as to take advantage of low levels of tax in the relevant member state. The Commission hopes that automatic exchange of information will increase transparency between member states and thereby facilitate greater detection of abusive arrangements. This will, in turn, assist in effective application of the principles of the EU GAAR.

It will be interesting to monitor the progression of the tax transparency package, which includes further measures such as possible new transparency requirements for multinationals, as well as any action taken to implement BEPS initiatives.

With acknowledgment to the contributions of trainee solicitor Cristiana Bulbuc and tax assistant Rebecca Pinder of Joseph Hage Aaronson.

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**TJ topics: Accelerated payment notices**

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