

OECD AND EU BEPS POLICY–THE RIGHT PATH TAKEN

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ОИСР И ПОЛИТИКАТА BEPS НА ЕС – ВЕРНИЯТ ПЪТ

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Abstract: Following various tax avoidance scandals which came to light after the economic crises of 2008 many actions were taken the combat Base Erosion and Profit Shifting (BEPS) and various Directives were issued to increase tax transparency.

In this context, this article describes and compares the OECD and EU initiatives to combat BEPS and investigates if the measures are in line with its aim and purpose.

A second part reflects the current trends regarding disclosure mechanisms, such as Country-by-Country Reporting, Mandatory Disclosure and the Ultimate Beneficial Owner Register. The article explores the significant burden for companies to collect all the information, the practical difficulties and uncertainties resulting from sometimes vague definitions and some policy considerations.

Keywords: Base Erosion and Profit Shifting (BEPS), Country-by-Country Reporting, Mandatory Disclosure, Ultimate Beneficial Owner Register.

Резюме: След различни скандали, свързани с избягване на данъци, които се появиха в периода след икономическата криза през 2008 г., бяха предприети различни действия за борба срещу ерозирането на данъчната основа и прехвърлянето на печалби (BEPS). Бяха приети и редица директиви, насочени към разширяване на данъчната прозрачност. Тази статия описва и сравнява инициативите на ОИСР и ЕС в борба с BEPS и прави анализ на съответствието на мерките на целта и предназначението им.

Втората част на анализа е фокусирана върху прилагането на съвременните тенденции на предоставянето на отчети по държави, задължителния автоматичен обмен на информация между данъчните органи, осигуряването на достъп до регистрите за действителните собственици. Статията изследва и тежестите за компаниите, произтичащи от необходимостта да се събира определена информация, както и от съществуващите практически трудности и от несигурността, породена вследствие на неясни разпоредби и различни политически съображения.

Ключови думи: ерозиране на данъчната основа и прехвърляне на печалби, отчети между държавите, обмен на информация, достъп до регистрите за действителните собственици.

1. Introduction

Following the financial crisis in 2008, and a period in which various tax scandals came to light, such as the Lux Leaks affair in 2015¹, the Panama Papers I and II in 2016 and 2018² and the Paradise Papers in 2018³ and in July 2019 the Mauritius papers⁴, there was an expanding call for more tax revenue protection and transparency.

Moreover, in recent years, the EU Commissioner for competition, Mrs Vestager, has investigated whether or not various tax rulings granted to multinationals in Belgium, Ireland, Luxembourg and the Netherlands constitute incompatible State aid.⁵

As a result, a lively public debate has arisen regarding whether or not companies are paying their fair share of tax. This debate has, amongst others, been initiated by NGOs, governments, parliamentary committees, the press, social media and investors.

In this context, a substantial number of aggressive tax planning structures have come to light. These resulted from the fact that multinationals were exploiting loopholes in the international tax framework and because states used tax competition as a tool for attracting inward investments. In the current dynamic trade world enterprise functions assets and risks are located at the location and within the group company which is regarded as most suitable.

Consequently, the call for measures to combat base erosion and profit shifting (BEPS) and for disclosure mechanisms became louder. In recent years, countries have increasingly voiced their concern regarding the financial challenges they face due to base erosion and profit shifting.⁶ A stable financial situation is, inter alia, required to finance infrastructure, social security services, climate change measures and developing of the country.

In response to this call, both the OECD and the European Union have taken significant BEPS measures and established a steadily growing number of fiscal disclosure mechanisms in recent years. Attacking base erosion to protect tax revenue required a joint action to create an equal level playing field in a dynamic world with lots of cross-border tax planning.⁷

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¹ Available at <https://www.icij.org/investigations/luxembourg-leaks/>.

² Available at <https://www.icij.org/investigations/panama-papers/>.

³ Available at <https://offshoreleaks.icij.org/>.

⁴ Available at <https://www.icij.org/investigations/mauritius-leaks/treasure-island-leak-reveals-how-mauritius-siphons-tax-from-poor-nations-to-benefit-elites/>.

⁵ For an overview of the cases, see http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html.

⁶ Ring, D. Transparency and Disclosure, Papers on Selected Topics in Protecting the Tax Base of Developing Countries, in United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries pp. 571-652 (2nd ed., United Nations 2017).

⁷ De Graaf, A., Visser, K-J., BEPS: Will the current Commitments and Pear Review Model Prove Effective, EC tax review. - Alphen aan den Rijn. - Vol. 27 (2018), no. 1 ; p. 36-47.

Multinationals must terminate aggressive tax planning, cooperate or face damage to their reputation, which may harm the trust of their stakeholders. In addition, countries are looking for measures to provide them with sufficient and appropriate information in order to adequately apply and administer national tax laws. This information is needed to ensure tax transparency concerning the activities of companies and to gain insight into the structuring of cross-border business operations, as well as investment policy.

This article will provide an overview of and comment on the measures taken by both the OECD and the EU to combat tax avoidance. In addition, the measure to increase transparency will be described. In this context the policy goals behind all measures will be investigated to determine whether the right path is taken.

2. The OECD measures to combat tax avoidance

The OECD published its first BEPS report in 2013⁸, which was followed by a flood of articles, papers and comments. One of the to the point conclusions of the OECD was that: *“the international common principles (...) may not have kept pace with the changing business environment. Domestic rules for international taxation and internationally agreed standards are still grounded in an economic environment characterized by a lower degree of economic integration across borders, rather than today’s environment of global taxpayers, characterised by the increasing importance of intellectual property as a value-driver and by constant developments of information and communication technologies.”*⁹

This resulted on 5 October 2015 in an action program of 15 points, which embedded a comprehensive and broad offensive to change international taxation.¹⁰ Common principles and practices, which were used for decades, were suddenly questioned. This policy shift was motivated by the fact that current international tax standards may not have kept pace with the changes in global business practices, in particular at the area of intangibles and the development of the digital economy.¹¹ Furthermore, the OECD observed that a number of indicators show that the tax practices of some multinational companies have become more aggressive over time, which raised serious compliance and fairness issues.¹²

As a response, the OECD proposals do not only tackle tax evasion, but also tax avoidance and tax planning. This means that companies can no longer always go for their best tax result. What the OECD reports, however, not do is making a more in-depth research as to whether the current corporate income tax framework needs to be changed. This question can be posed at it was set up and a far less dynamic world and because the various systems differ significantly.

⁸ OECD, *Addressing Base Erosion and Profit-Shifting* (OECD 2013), International Organization Documentation, IBFD.

⁹ Id. at p. 5, 7, 27, 28 and 49.

¹⁰ For a comment on both the OECD and EU BEPS measures, see Vanistendael, F., European Union/International/OECD – Is Tax Avoidance the Same Thing under the OECD Base Erosion and Profit Shifting Action Plan, National Tax Law and EU law?, *Bulletin For International Taxation*, March 2016, p. 163-172.

¹¹ OECD, *supra* n. 8 at p.6.

¹² Id., at p.7.

2.1. The main OECD action points to combat tax avoidance

As it is not possible to describe 15 BEPS Action points in detail, the focus will be on those which combat tax avoidance, base erosion and profit shifting (BEPS).

2.2. Hybrid financial instruments

The first important action point concerns Action point 2 on hybrid financial instruments to combat hybrid mismatch arrangements, for example, with respect to debt instruments.¹³ The main rule of this action point is that if the payer jurisdiction does not neutralize a mismatch which results in double non-taxation by not allowing a deduction, the payee jurisdiction should not grant an exemption for the income received. Furthermore, states which avoid double taxation by means of an exemption with respect to foreign dividends should in their tax treaties include a rule allowing them to switch to the credit method if those dividends were deductible in the country of the payer.

Regarded as deductible items are interest, issue discount, redemption premiums, facilities and lending fees, payments under a Derivative contract which are considered as a separate item of deductible expenditure and payments giving rise to an equivalent tax relief.¹⁴

2.3. CFC

A clear measure to combat profit shifting concerns action point 3 on Controlled Foreign Companies (CFC).¹⁵ The CFC-legislation applies to parent companies that have a decisive influence on foreign low-taxed subsidiaries. Decisive influence exists if the taxpayer alone, or together with its associated enterprises, holds a direct or indirect participation of more than 50% of the voting rights, owns directly or indirectly more than 50% of the capital, or is entitled to more than 50% of the profits of the foreign company. In addition, the tax rate applicable to the CFC must be lower than that of the parent company. The final report on Action 3 specifies that if those conditions are met dividends, interest, insurance income, royalties and IP income and sales and services income should be included in the profits of the parent company.

The CFC –rules do, however, not apply if the foreign company is set up for valid commercial reasons that reflect economic reality. This means that only transactions and constructions from abusive tax planning set-up to reduce taxes are within the scope of CFC-rules.

2.4. The interest barrier

Interest deduction possibilities are often used to significantly reduce the tax burden. For this purpose three basic scenarios are used:

- 1) groups place high levels of third-party debt in high-tax counties;
- 2) groups use intra-group loans to generate interest deductions exceeding the group's actual third-party interest expense; and
- 3) groups using third party or intra-group financing to fund the generation of tax exempt income.

¹³ OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements*, (OECD 2015), International Organization Documentation, IBFD.

¹⁴ OECD, *Supra* n. 8 at. paras 30-31.

¹⁵ OECD, *Designing Effective Controlled Foreign Company Rules*, (OECD (2015), International Organization Documentation, IBFD.

These tax planning structures are combated by BEPS action point 4.¹⁶ The necessity to introduce a general interest-barrier rule was further motivated with the fact that:

- (1) The current fixed ratios are considered too high to be an effective tool in addressing base erosion.
- (2) Targeted anti-avoidance rules can never catch up to expanding profit shifting opportunities.
- (3) Withholding tax on interest payments is often reduced (in many cases even to zero) under tax treaties.

In chapter 4 of the Final report the following recommendations for a best practice approach are included¹⁷:

- (1) An optional de minimis monetary threshold to remove low-risk entities, based on the net interest expense of the local group, should be established.
- (2) Each group entity should be allowed to deduct net interest expense up to a benchmark net interest/EBITDA ratio preferably within a range of 10%-30%, i.e. a fixed ratio rule”.
- (3) Each group entity should be allowed to deduct net interest expense up to its group’s net interest/EBITDA ratio, where this is higher than the benchmark fixed ratio. In addition, each country should have the option of applying an uplift to a group’s net third-party interest expense of up to 10%. Countries are entitled to apply different ratios or no ratio at all. This is known as the “group ratio rule”.

(4) Each country should have the option of providing for carry-forward of disallowed interest/unused interest capacity and/or carry-back of disallowed interest.

(5) Targeted rules to support general interest limitation rules and to address specific categories of risk should be adopted.

(6) Specific rules should apply to address issues raised by the banking and insurance sectors.

The main company policy aspects are the dealing with debt capacity, the determination of the place where the company’s business model and profit should be centralized, the prevention of leakage through deemed dividends, to alter the current leveraged structure to a new one more quickly and in a less costly manner and the avoidance of non-deductibility of interest.

2.5. Harmful tax practices

A very important action point concerns no. 5 dealing with the combating of harmful tax practices.¹⁸ This action point deals with artificial profit shifting to benefit from preferential tax regimes and the lack of transparency with respect to cross-border tax rulings. Therefore, it is recommended that profits are taxed in the country where substantial activities take place, the so-called nexus approach. This approach had a substantial impact on IP-regimes because the patent or innovation box incentive no longer can be granted by a country if not a significant

¹⁶ OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments* (OECD 2015), International Organization Documentation, IBFD.

¹⁷ For a comment on PES Action 4 and the interest-barrier in the EU ATAD Directive see Offermanns, R.H.M.J., Huibregtse, S., Verdoner, L., Shood, A., *European Union - BEPS Action 4: Policy Considerations and Implementation Status*, European Taxation, 2017 (Volume 57), No. 2/3, p. p. 47-68.

¹⁸ OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, OECD (2015), International Organization Documentation, IBFD.

part of the profit-generating activities takes place there. Furthermore, this action point has resulted in a broad exchange program regarding cross-border rulings.

2.6. Treaty abuse

Action point 6 on treaty abuse recommends the inclusion of a limitation on benefits (LOB) clause in tax treaties.¹⁹ Under this clause treaty benefits would be granted to qualifying residents in case of an ownership of at least 50% of the capital or voting rights of the company and several other conditions are met, including a stock exchange test.

Companies with a smaller participation may also obtain treaty benefits if the tax authorities of their state of residence based on all facts and circumstances of a case determine that the establishment, acquisition or maintenance of the company and its activities carried out do not have as one of its principal purposes to obtain treaty benefits. If the competent authority of the requested state intends to deny treaty benefits, it should, however, first consult the authority of the other treaty state.

It has to be seen how this recommendation will work out in practice, because for multinationals the existence of a good treaty network may be important factor for the place of establishment chosen.

In addition, it should be clarified that tax treaties do not aim to create situations of double non-taxation.

2.7. Combined effects of the measures

Due to the extensive number of BEPS-measures companies now have to be very careful in their tax planning to avoid a significant increase of the tax burden because the various measures have a significant cumulative effect as follows from the following example.

Presume Country A has a corporate income tax rate of 25% and a withholding tax on interest of 10%. Company X, established in that country receives CFC income of 100 and pays interest of 100. The non-deductible interest under the interest barrier is presumed to be 50%. The last presumption is that for an amount of 100 no exemption can be granted or this amount is non-deductible due to a mismatch.

The effects of the various BEPS action points are as follows:

<i>Action point</i>	<i>Additional tax</i>
Action 3 CFC	25 (25% of 100)
Action 4 Interest barrier	12.5 (50% of 100) x 25% 10 (10% WHT from 100)
Action 2 and 5 hybrid mismatch and harmful tax competition	25 (25% x 100)
Action 6 treaty abuse	10 (10% x 100)
Total	82.5

¹⁹ OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD (2015), International Organization Documentation, IBFD.

Finally, it, however, has to be acknowledged that the entire BEPS plan has only a few minimum standards, which OECD Members have to implement. From the above described action points it concerns action points 5 and 6. Other points are transfer pricing and country-by-country reporting (action 13)²⁰ which obliges multinationals to document where the profits are made and Making Dispute Resolution Mechanisms More Effective (action 14)²¹, amongst others, dealing with Mutual Agreement procedures, which are invoked in case of interpretation differences between two countries.

This means that most of the BEPS measures are optional, leaving a lot of leeway to the OECD Member States to which extent they want to implement the OECD BEPS-package.

2.8. Implementation follow-up

In order to monitor the implementation of the minimum standards, the OECD established the Inclusive Framework on BEPS. A system of monitoring and peer reviews is used to encourage the OECD Member States to implement and apply the OECD minimum standards. The framework will also investigate the implementation of the other BEPS measures.

3. The EU BEPS measures

As the OECD BEPS-package was regarded as too non-committal, the EU Member States in 2016 and 2017 adopted two Directives to combat tax-avoidance, i.e. the ATAD I²² and II²³ Directives.²⁴ The introduction of those Directives was motivated with the fact that the European Commission intended to guarantee a uniform BEPS interpretation by all EU Member States to create an equal level playing field. In the preamble to the Directive it is, therefore, stated that the scope of the Directive is to enhance effective taxation in the internal market by adopting measures against aggressive tax planning which are consistent with the OECD BEPS conclusions.²⁵ The Directive should grant a uniform and coordinated application of the recommendations and best practices therein, creating a minimum level of protection for national corporate tax systems against tax avoidance practices across the Union.²⁶

In deviation from the BEPS program those directives do not provide for the suggestion to include a limitation on benefits clause in tax treaties. This because the EU is not competent to interfere in tax treaties.

Finally, it should be noted that the EU Directives address BEPS between related companies other BEPS situations are thus not yet combatted.

²⁰ OECD, *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*, OECD (2015), International Organization Documentation, IBFD.

²¹ OECD, *Making Dispute Resolution Mechanisms More Effective*, OECD (2015), International Organization Documentation, IBFD.

²² Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, International Organization Documentation, IBFD.

²³ Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, International Organization Documentation, IBFD.

²⁴ For a description of an comment on the ATAD 1 measures see Ginevra, G., *The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU Level*, Intertax 2017 (vol. 45), No.2, pp. 120-137.

²⁵ Supra note 22, at paras 2-3 of the Preamble to the Directive.

²⁶ Ibid.

3.1. GAAR

The most important provision of the ATAD1 Directive is the General Anti-Avoidance Rule (GAAR). Article 6(1) of the Directive provides that: *"For the purposes of calculating the corporate tax liability, a Member State will ignore 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 the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part."* Article 6(2) indicates that an arrangement or a series thereof will be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

This provision combats both cross-border and domestic constructions which aim to obtain a tax advantage which is against the aim and purpose of a law. This constitutes a big policy change because based on the subsidiarity principle of article 3 of the Treaty on the functioning of the European Union (TFEU)²⁷ it was always held that the EU could not interfere in the domestic tax policy. Another indication provides article 105 of the TFEU which regulates that the European Commission may issue Directives for the approximation of such laws, regulations or administrative provisions of the Member States, which directly affect the establishment of functioning of the internal market.²⁸ Another problem is the determination of the aim and purpose of the law. In countries like the Netherlands, this can be deduced from the Explanatory Memorandum but not all Member States provide for such extensive explanation.

In addition, it has to be seen how the term "non-genuine" will be interpreted because in EU case law so far the term artificial construction was used.²⁹ In the Cadbury Schweppes, the European Court of Justice developed several strict borderlines to abuse. No tax abuse exists if an existing company establishes another company in another Member State merely to benefit from a preferential tax regime. A restriction of the EU treaty freedoms is in the case of abusive practices only allowed in case of wholly artificial structures. Secondly, it is required that from the objective facts it

follows that the construction at issue is add odds with the aim behind the freedom of establishment, for example, when no real economic activities are carried out.

A first conclusion is that the new GAAR concept has much broader scope. The ATAD GAAR also clearly deviates from EU case law rules and it remains to be seen how the ECJ will interpret this new GAAR in future court cases .

²⁷ Treaty on the Functioning of the European Union, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT>.

²⁸ For a comment on this policy change and the effect whether a Directive as the most suitable tool to combat EU BEPs, see De Graaf, A./Visser, K-J., ATA Directive: Some Observations Regarding Formal Aspects, EC tax review. - Alphen aan den Rijn. - Vol. 25 (2016), no. 4 ; p. 199-210.

²⁹ A leading case in this respect was the Cadbury Schweppes plc Case C-196/04. In this case the Court of Justice decided that: *"Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host Member State and carries on genuine economic activities there"*.

3.2. Interest barrier

The other provisions of the Directive mainly cover the OECD BEPS action plan and the provisions are generally quite similar. The interest barrier, which is included in article 4, limits the deduction of interest to a fixed ratio which is equal to 30% of a company's taxable earnings before interest, tax, depreciation and amortization (EBITDA). Instead, the aforementioned ratio may also be applied to a group of companies. The Directive provides for the following escapes from the provision:

1) An equity escape under which a company's level of equity and assets is compared with that of a group.

2) Furthermore, a de minimis rule may be applied under which excess borrowing costs up to an amount of EUR 3 million are excluded for stand-alone companies and companies acting for the public benefit.

A last important aspect concerns an option for the Member States to apply a carry forward or carry back for excess borrowing costs which cannot be used and an unused deduction capacity or both.

Member states are allowed to main existing rules which are equally effective until 2024.

Article 4 is clearly contradictory to the aim of the Directive to guarantee a uniform and coordinated approach. On vital aspects such as the ratio, the carve out rules and the carry forward or carry back of exceeding borrowing costs options exist. In addition, it must be noted that article 3 allows the Member States to maintain already existing stricter rules, which are equally effective. As Prof. Dourado rightfully concluded, the various options gave rise to an over-complicated implementation pattern, legal uncertainty and inconsistencies.³⁰ Moreover, it results in different level playing fields. In countries which, for instance, do not apply a group ratio the tax burden may become higher than in countries which allow the application of such ratio. This means in practice that the Directive has created competition distortions. Finally, a discussion could arise about the fact whether measures are equally effective. This follows, from a set of initiatives regarding Member States' implementation of ATAD, launched by the European Commission on 25 July 2019, requesting Austria and Ireland by letter of formal notice to take implementation measures concerning article 4 of the Directive, while Denmark was asked to implement articles 7 and 8 on CFC.³¹

The interest barrier is a clear contribution to the termination of base erosion. However, the provision is very strict and does not take into consideration that a choice for debt-financing is not always tax driven.³² Consequently, its effect on business investments in Europe should be strictly monitored to guarantee that Europe remains competitive.

3.3. CFC

BEPS Action point 3 on CFC is included in articles 7 and 8 of the Directive. The objective of these provisions is to re-attribute the (non-distributed) income of a low-taxed controlled subsidiary to its parent company so that the latter becomes taxable on this

³⁰ Dourado, A.P., The EU Anti-Tax Avoidance Package: Moving Ahead of BEPS? Intertax, 2016, Vol. 44, Issue 6/7 at pp. 440-446.

³¹ See, https://ec.europa.eu/commission/presscorner/detail/en/inf_19_4251.

³² In the same sense Hoor, O.R./O' Donnell, K, BEPS Action 4: When Theory Meets Practice, 78 Tax Notes International (2015), p. 643-644.

attributed income in the State where it is resident for tax purposes.³³ The preamble to the Directive also clarifies that the CFC-rules should target only artificially diverted income which is attributable to decision-making functions, which are performed at the level of the parent company. Situations where a low risk of profit shifting exists should be carved out.

The Commission acknowledged that many Member States already had CFC-rules.³⁴ However, as the differences between their scope and application was significant, taxpayers could set-up structures to circumvent the application of these rules. Therefore, the Commission regarded it as necessary to include a common set of rules in the Directive. However, article 3 of the Directive also allows the Member States to maintain existing rules which provide for a higher level of protection.

The definition of a CFC is comparable to that of BEPS Action point 3. Regarded as such is an entity established in Europe or elsewhere which is (1) controlled directly or indirectly by a parent company established in another EU Member State and (2) is subject to an actual corporate tax rate that is lower than the rate to which it would have been charged if it was established in the jurisdiction of the parent company. It applies also to permanent establishments. Decisive is that the parent company has both legal and economic control by holding directly or indirectly, by itself or together with associated enterprises, more than 50% of the voting rights or capital of the CFC or a participation in the CFC which gives entitlement to receive more than 50% of its profits. This broad definition prevents that CFC-rules can be circumvented by fragmenting the control or splitting the income across multiple subsidiaries.

Making the application of the CFC rate dependent on the applicable tax rate of the state of the parent company may result in huge differences as the rates vary significantly. The rate is 9% in Hungary and 35% in Malta. Some countries apply a special rate for the CFC-legislation. In the Netherlands, for instance, this rate is 9%. In addition, it must be noted that the Netherlands applies a statutory rate. If the tax base is small, the effective rate may, however, be significantly lower. At all events the CFC-range may substantially differ between the Member States and race to the bottom may arise.

For the re-attributed profits, the Member States can opt between two systems. Firstly, they can tax a list of income types including interest, royalties, intellectual property income, dividends, income from financial leasing, income from financial activities and sales and services income. The second option concerns the application of a substance test. Under this test all profits arising from non-genuine arrangements which have been put in place to obtain a tax advantage are taxed.

The CFC-rules do not apply to financial undertakings if on third or less of the entity's income comes from transactions with the taxpayer or its associated enterprises.

For companies applying the non-genuine arrangements test it is vital that the CFC has enough substance. This can be deduced from a functional analysis of the significant people functions, assets and risks. Further more substance can be shown by the number of employees, equipment assets and premises.

³³ Paragraph 12 of the Preamble to the Directive.

³⁴ Staff Working Document (COM)923 final of 28 January 2018, at. 22.

Under a de minimis rule entities or PEs with accounting profits not exceeding EUR 750,000 and non-trading income not exceeding EUR 75,000 or accounting profits not exceeding more than 10% of the operating costs during tax year can be excluded.

The CFC-income is allocated to the parent company pro rata its participation.

Because, the CFC definitions are broad, the CFC rules will certainly contribute to a reduction of unfair competition. However, various definitions leave room for interpretation differences, in particular the substance carve out. This may create differences and uncertainty. Finally, no rule for the avoidance of double taxation is included in the case where CFC income is taxed by two Member States, which does not seem fair, but will certainly discourage companies from shifting profits to a CFC-country. At all events it is contrary to the preamble which indicates that no situations of double taxation should arise.³⁵

3.4. Hybrid mismatch

3.4.1. ATAD 1

A last important provision is article 9 which in line with BEPS action 2 deals with hybrid mismatch arrangements. Such mismatches are the result of disparities in the tax classification methods of Member States and their autonomous application. The EU measures do not deal with the cause of the mismatches but only with the symptoms. The provision includes rules for combating mismatches regarding the classification of partnerships (transparent/non-transparent) and it addresses hybrid financial instrument mismatches (the classification as equity or debt).

The provision covers structures between associated enterprises or structural arrangements between parties.

The term "associated enterprise" for the application of the provision by article 2(9) of the Directive is defined as (1) a company in which the taxpayer holds directly or indirectly a minimum participation of at least 25% of the voting rights or capital; and (2) an entity or individual which holds the same minimum participation in the taxpayer alone or also in respect of other associated enterprises. A relevant factor is also the economic control which entitles to receive more than 25% of the profits of the entity concerned. In case a hybrid entity is involved the participation threshold is increased to 50%.

The term hybrid mismatch in article 2(9) of the Directive is defined as: "hybrid mismatch" means a situation between a taxpayer in one Member State and an associated enterprise in another Member State or a structured arrangement between parties in Member States where the following outcome is attributable to differences in the legal characterization of a financial instrument or entity:

(a) a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred or the losses are suffered and in another Member State ('*double deduction*'); or

(b) there is a deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion for tax purposes of the same payment in the other Member State ('*deduction without inclusion*')."

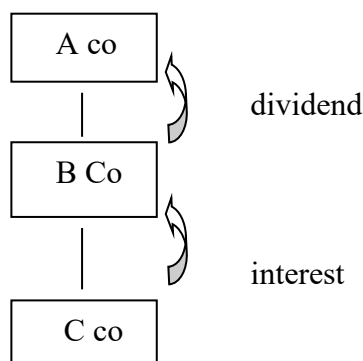
A clear example where double deduction may occur concerns the deduction of interest in case of a hybrid entity. In that case a deduction can be claimed in the country where the

³⁵ Paragraph 5 of the preamble of the ATAD Directive.

entity is situated as well as in the country of the foreign investors. In that case the interest should only be deductible in the country where the payment has its source.

In case of a deduction non-inclusion situation the Member State of the payer should deny the deduction. The outcome is that a double-non taxation outcome is converted into a taxation in the state of the payer.

An example is a hybrid financial instrument situation, such as a hybrid loan which in the country of the payer is classified as a debt and in the country of the recipient as an equity supply.



The country of C Co will allow a deduction of the interest paid to B Co, while the interest is not taxed in the hands of the ultimate recipient A Co, because the state of A Co classifies the payment by B Co as a dividend to which the participation exemption applies. C Co should then deny the deduction.

This rule applies if B Co is established in an EU Member State or in a third country. However, when an intermediary in a third country is interposed it will be possible to show that this is done for valid commercial reasons.

Contrary to the OECD BEPS 2 Action point a definition of deductible items is missing in the Directive.

3.4.2. ATAD II

Scope

The ATAD II Directive³⁶ expands the hybrid mismatch provision to third countries and adds several more hybrid mismatch situations, which were not included in the ATAD I Directive. It concerns the imported mismatches, dual inclusion of income, hybrid transfers and reverse hybrid mismatches.

The general scope of the ATAD II Directive is defined in article 1(1)(1) of the Directive clarifying that it applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country. Article 1(1)(2) of the Directive provides that it also applies to all entities that are treated as transparent for tax purposes by a Member State.

The term hybrid mismatch in article 2(9) of the Directive is defined as situation of double deduction or deductions without inclusion of a payment in the taxable profits of accompany within a reasonable time.

³⁶ Supra n. 19.

The legal characterization is included in article 2(9)(a) and 2(9)(b) of the Directive. The mismatch must result from differences in the characterization of an instrument. Regarding hybrid entities, the mismatch outcome must result from differences in the allocation of payments made to the hybrid entity under the laws of the jurisdiction where the hybrid entity is established or registered and in the jurisdiction of any person with a participation in that hybrid entity.

Mismatch situations

The most important provisions of the ATAD II Directive are the articles 9a and 9b which cover reverse hybrid mismatches and tax residency mismatches, respectively.

Furthermore, the scope of the hybrid mismatches included in article 9 of the ATAD I Directive is broadened and it covers mismatches in the following four situations:

- 1) hybrid mismatches resulting from payments under a financial instrument (article 2(9)(a) of ATAD II);
- 2) hybrid mismatches resulting from differences in the allocation of payments made to a hybrid entity (Article 2(9)(b) of ATAD II) or a PE (article 2(9)(c) of ATAD II) and mismatches resulting from a disregarded PE (Article 2(9)(d) of ATAD II);
- 3) hybrid mismatches resulting from payments made by a hybrid entity to its owner (Article 2(9)(e) of ATAD II) or deemed payments between the head office and a PE or between 2 or more PEs (Article 2(9)(f) of ATAD II); and
- 4) Double deduction outcomes resulting from payments made by a hybrid entity or PE (Article 2(9)(g) of ATAD 2).

The inclusion of these additional categories aims to bring the Directive more in line with OECD BEPS action point 2. Striking, is that contrary to the OECD BEPS recommendations also PE situations are covered. The OECD took the view that these situations required more study.

Corresponding inclusion

Contrary to the ATAD I, the ATAD II Directive contains some helpful guidance in form of various definitions to clarify the corresponding inclusion. Those are based on BEPS action 2 because paragraph 27 of the preamble for the implementation refers to the explanations and examples of this action point to the extent that those are consistent with the provisions of this Directive and Union law. An important gap is that the Directive does not clarify where consistency is lacking.

The Directive defines that a hybrid mismatch shall 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. Firstly, the term double deduction is defined as: *“a deduction of the same payment, expenses or losses in the jurisdiction in which the payment has its source, the expenses are incurred or the losses are suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction). In the case of a payment by a hybrid entity or permanent establishment the payer jurisdiction is the jurisdiction where the hybrid entity or permanent establishment is established or situated.”*

Secondly, the term deduction without inclusion is in this context defined as: *“the deduction of a payment or deemed payment between the head office and permanent establishment or between two or more permanent establishments in any jurisdiction in which that payment or deemed payment is treated as made (payer jurisdiction) without a*

corresponding inclusion for tax purposes of that payment or deemed payment in the payee jurisdiction. The payee jurisdiction is any jurisdiction where that payment or deemed payment is received, or is treated as being received under the laws of any other jurisdiction.”

Finally, the term “inclusion” is defined as: *“the amount that is taken into account in the taxable income under the laws of the payee jurisdiction. A payment under a financial instrument shall not be treated as included to the extent that the payment qualifies for any tax relief solely due to the way that payment is characterized under the laws of the payee jurisdiction. The term “included” shall be construed accordingly.”*

A last important definition concerns “dual inclusion income” meaning: *“any item of income that is included under the laws of both jurisdictions where the mismatch outcome has arisen.”*

Associated enterprises

Compared to ATAD 1, the ATAD 2 Directive also has significantly extended the scope of the definition of associated enterprises. Firstly, the 50% requirement now also applies to the additional hybrid entity situations included in the ATAD II Directive. Secondly, a person acting together with another person in respect of the voting rights or owned capital of an entity will be treated as holding a participation in all voting rights or capital ownership of that entity, held by the other person. Thirdly the term also includes an entity, that is part of the same consolidated group for accounting purposes as the taxpayer, i.e. an enterprise in which the taxpayer has a significant influence in the management or an enterprise that has a significant influence in the management of the taxpayer.

This broadening implies that hybrid mismatch rules only apply if one of the associated enterprises has effective control over the other associated enterprises.

Comparison Table of main OECD and EU BEPS action points.

<i>Action point</i>	<i>OECD</i>	<i>EU</i>
Interest deduction limitation	<p>Fixed ratio rule which allows a deduction of net interest up to a bench mark, net interest/EBITDA ratio within a range of 10%-30%. As an alternative the higher group net interest/EBITDA ratio may be used.</p> <p>A de minimis specific monetary threshold may be used, but no specific amount mention</p> <p>Exemption for:</p> <ul style="list-style-type: none"> - grandfathering clause <p>may be applied for a fixed</p>	<p>The maximum deduction is the higher of up to 30% of the EBITDA or 3 million.</p> <p>Consolidate group or separate entity approach.</p> <p>Exemptions:</p> <ul style="list-style-type: none"> - the cap does not apply to loans existing on 17 June 2016 if those are not modified (grandfathering clause). - standalone entities -long-term infrastructure projects

	<p>period or indefinitely</p> <ul style="list-style-type: none"> - standalone entities may be excluded; - public benefit projects; - best practice equity escape rule; - financial undertakings <p>Carry-back and carry-forward of exceeding borrowing costs or unused interest capacity for limited period recommended</p>	<p>- equity escape provision for accounting groups</p> <p>Carry-back and carry-forward of exceeding borrowing costs or unused interest capacity for 3 to 5 years</p> <p>Further studies on the position of financial undertakings.</p>
Exit tax	No rule included.	<p>Capital gains derived from the transfer of assets within a multinational group to another country taxed.</p> <p>Conditional deferral possibility and payment in 5 yearly instalments.</p> <p>Applies also to EEA states if an agreement on mutual assistance for the recovery of tax claims exist.</p> <p>Receiving Member state may dispute the asset value set by the exit Member state.</p>
GAAR	Not included. Only a principle purpose test is designed to combat treaty abuse.	<p>Applies to (a series of) artificial arrangements designed to obtain tax advantages.</p> <p>An arrangement or a series thereof will be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect</p>

		<p>economic reality.</p> <p>If an arrangement is ignored the tax due is calculated by means of the domestic law rules.</p>
CFC rules	<p>Rule to prevent a profit shift too controlled subsidiaries in low tax jurisdictions. Optional territorial approach.</p> <p>Rules apply to companies and PEs</p> <p>50% threshold to define director indirect, as well as legal or economic control</p> <p>Effective tax rate that is sufficiently similar to the tax rate used in the parent jurisdiction.</p> <p>Substance carve out based on the significant peoples functions.</p> <p>Substance rule may be used on a transactional basis</p> <p>Exclusion for entities that do not earn a certain amount or percentage of CFC income or exemption for certain activities</p> <p>Application of de minimis threshold allowed</p> <p>CFC income calculated in accordance with the rules of the parent jurisdiction and allocation pro rate the participation</p> <p>Avoidance of double</p>	<p>The rules are similar and apply to companies and PES</p> <p>Same rules apply to all CFCs in third countries.</p> <p>50% threshold to define director indirect, as well as legal or economic control</p> <p>Actual corporate income tax paid decisive</p> <p>Definition of CFC income is broader.</p> <p>The income types are broader as income from financial leasing and income from banking and other financial activities are included.</p> <p>Substance carve out rule.</p> <p>This rule may be used on a transactional basis.</p> <p>Exemption if one third or less of the income accruing to the entity or permanent establishment is CFC income</p> <p>Threshold exemptions for transactional approach.</p> <p>CFC income calculated in accordance with the rules of the parent jurisdiction and allocation pro rate the</p>

	taxation	participation Losses are carried forward Avoidance of double taxation
Hybrid mismatch	Use of differences between domestic tax systems aimed to a double deduction or a deduction no inclusion situation in another country regarding cross-border payments attacked. In case of double deductions no limitation to associated enterprises even if the companies are in the same control group or the mismatch results from a structured arrangement. Anti-fragmentation rule included.	Similar rules but separate Directive to combat such structures in relation to third countries. The scope is narrower, in case of double deduction situations, because it is restricted to associated companies. Broader is that also permanent establishment situations are covered. No definition of deductible items is included.

4. Transparency disclosure measures

As BEPs calls for broader insight in cross-border tax planning structures since 2015 various action have been taken by the OECD and the EU to increase cross-border information exchange.

4.1. OECD Disclosure measures

The first important measure already originates from 1988, when the first multilateral instrument to exchange information was put in place, i.e. the Multilateral Convention on exchange of information³⁷ which meanwhile has been signed by 129 states and has entered into force in 118 of them.³⁸ This Convention provides for all types of exchange, i.e. exchange upon request, spontaneous exchange and automatic exchange of information.

Important measures were included in the BEPS Final Reports on Actions 12 and 13, which were released on 5 October 2015.³⁹ Action 12 obliges taxpayers to disclose information on aggressive tax planning arrangements. while Action 13 extends the transfer pricing documentation obligations, inter alia, on a country-by-country basis. This reporting

³⁷ Convention between the Member States of the Council of Europe and the Member Countries of the OECD on Mutual Administrative Assistance in Tax Matters (25 Jan. 1988) (as amended through 2010), Treaties IBFD.

³⁸Based on the status as of 6 August 2019, see https://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf.

mechanism should provide tax administrations with information about the income allocation by multinational enterprises, their economic activity and taxes paid in the various countries.

The reporting of information on a country-by-country basis consists in a Master File, a country-by-country (CbC) report and a Local File.

The Master File includes standard information for groups, such as the organizational structure, a description of the business, intangibles owned, intercompany financial activities and the financial and tax position of the group.

The CbC report also requires companies to include information on a country-by-country basis of tax revenues, earnings before taxes, cash tax, current tax year accruals, stated capital and accumulated earnings, number of employees and tangible assets. Also a list of companies and permanent establishments per country must be included.

Finally, the Local File contains information per jurisdiction to ensure that a company complies with the arm's length principle and transfer pricing rules in respect of transactions that relate to that country.

Finally, over the past years the OECD made significant efforts to promote the exchange of tax rulings amongst the contacting states. This resulted in an framework for compulsory and spontaneous exchange of information concerning tax rulings.⁴⁰

The obligation to spontaneously exchange information on tax rulings applies not only to future rulings, but also to past rulings that (i) were issued on or after 1 January 2010 and were still in effect on 1 January 2014 and (ii) those that were issued between 1 January 2014 and 1 April 2016.⁴¹

The exchange of information on these past rulings was to be completed by 31 December 2016, but as from as of 1 April 2016 exchange of information on new rulings takes place.

Under the BEPS framework, however, this exchange of information can only take place between states if there is an applicable tax treaty that provides for this or an agreement for the exchange of financial and tax information.⁴²

4.2. EU Disclosure measures

4.2.1. Exchange of tax rulings

The Mutual Assistance Directive (2015/2376),⁴³ requires Member States to automatically exchange information on advance cross-border tax rulings, as well as advance pricing arrangements.

³⁹ OECD/G20, Mandatory Disclosure Rules – Action 12: Final Report (OECD 2015), International Organizations' Documentation IBFD and OECD/G20, Transfer Pricing Documentation and Country-by-Country Reporting – Action 13: Final Report (OECD 2015), International Organizations' Documentation IBFD.

⁴⁰ OECD's User Guide for Tax Administrations on Exchange of Tax Rulings – XML Schema, Sept. 2017, available at <http://www.oecd.org/tax/exchange-of-tax-information/exchange-on-tax-rulings-xml-schema-user-guide-for-tax-administrations.pdf>; OECD press release concerning standardized IT-format for the exchange on tax rulings under BEPS Action 5, available at <http://www.oecd.org/tax/beps/oecd-releases-standardised-it-format-for-the-exchange-on-tax-rulings-under-beps-action-5.htm> (accessed 10 Apr. 2019); and OECD/G20, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2015 Final Report (OECD 2015), International Organizations' Documentation IBFD.

⁴¹ OECD User Guide, *supra* n. 87, at pp. 7-8.

⁴² As the ruling report template requires an indication of the “Legal Basis Type element”, i.e. the international legal instrument on the basis of which the exchange of the rulings takes place; see, in this regard, OECD User Guide, *supra* n. 87, at pp. 25-26.

Rulings concerning tax-driven structures have been a main focus, since recent experience has shown that such rulings may lead to a low level of taxation of artificially high amounts of income in the country issuing them, or amending or renewing them, leaving artificially low amounts of related income to be taxed in other jurisdictions.⁴⁴

The new Directive covers a wide range of advance cross-border rulings and advance pricing arrangements, such as:⁴⁵

- 1) unilateral advance pricing arrangements and/or decisions;
- 2) bilateral or multilateral advance pricing arrangements and decisions;
- 3) arrangements or decisions determining the existence or absence of a permanent establishment (PE);
- 4) arrangements or decisions determining the existence or absence of facts with a potential impact on the tax base of a PE;
- 5) arrangements or decisions determining the tax status of a hybrid entity in one Member State that relates to a resident of another jurisdiction; and
- 6) arrangements or decisions on an assessment basis for the purpose of depreciation of an asset in one Member State that is acquired from a group company in another jurisdiction.

These measures are already in force under the domestic legislation of the Member States, as they had an obligation to implement and publish the said rules by 31 December 2016 and apply them from 1 January 2017.⁴⁶

Thus, both EU Member States, as well as states having an international agreement or a tax treaty under which they are obliged to exchange their financial and tax information, have implemented measures guaranteeing that all tax authorities involved (at the global level), and all EU Member States (at the EU level), now have access to information on rulings.

4.2.2. The Ultimate beneficial ownership register

The UBO register results from the fourth Anti-Money Laundering Directive (2015/849), which entered into force on 25 June 2015.⁴⁷

The main goals of this Directive, which had to be implemented by the Member States by 26 June 2017, are to combat crime and terrorism and encourage a strong internal market, economic prosperity and financial stability and integrity. Therefore, all Member States were

⁴³ Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L332 (2015), EU Law IBFD.

⁴⁴ All final recent decisions regarding the European Commission's investigations and other open formal investigations are available at http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html; DG Competition, *Internal Working Paper – Background to the High Level Forum on State Aid* (3 June 2016), available at http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf.

⁴⁵ Recital 4 Council Directive (EU) 2015/2376.

⁴⁶ Id., at Recital 6.

⁴⁷ Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, OJ L 141/73 (2015), amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive

obliged to set up a register identifying the ultimate beneficial owner (UBO) of all companies and other legal entities incorporated in the various Member States.⁴⁸ The information for this register must be delivered by the companies and legal entities themselves.

Article 3(6) of the Anti-Money Laundering Directive (2015/849) provides a definition of the UBO. It includes any natural person(s) who ultimately own(s) or control(s) the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted. With regard to corporate entities the term includes the following persons (article 3(6)(a)(i) and (ii)):

- 1) the natural person(s) who ultimately own(s) or control(s) a legal entity through direct or indirect ownership of more than 25% of the shares (including bearer shares) or voting rights or ownership interest in that entity or control(s) the entity through other means. Member States may decide to use a lower percentage. Moreover, the rule does not apply to listed companies because those entities are subject to disclosure requirements consistent with Union law or subject to equivalent international standards that ensure adequate transparency of ownership information; and
- 2) if the UBO cannot be determined on the basis of control or doubts exist as to whether the persons identified are, actually, the UBO, the senior managing directors of the company are regarded as such.

Article 3(12) of the Anti-Money Laundering Directive defines “senior management” as an officer or employee with sufficient knowledge of the institution’s money laundering and terrorist financing risk exposure and sufficient seniority to take decisions affecting its risk exposure.

With regard to legal entities, such as foundations, and legal arrangements similar to trusts, the UBO will be the controlling person or the person in whose interests the entity or legal arrangement operates (as per article 3(6)(c) of the Directive). In addition, the Directive contains special rules for trusts.

Article 11 of the Directive provides that the entities concerned must apply customer due diligence measures when establishing a business relationship, carrying out occasional

2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, available at <http://data.europa.eu/eli/dir/2015/849/oj>.

⁴⁸ For a detailed overview of the latest disclosure mechanisms for companies, see Moniz, R. Botelho, Offermanns, R.H.M.J., European Union - Current Trends Regarding Disclosure Mechanisms: Reporting Ultimate Beneficial Ownership – Part 1, European Taxation, 2019 (Volume 59), No. 4, p. 162-168 and No. 5, p. 237-246 and Part 2, European Taxation, 2019 (Volume 59), No 5, p. 237-246.

transactions of EUR 15,000 or more, or in respect of fund transfers of EUR 1,000 or more. For persons trading in goods, it applies to transactions of EUR 10,000 or more. The identification of the customer and of the UBO must, according to article 14(1) of that Directive, take place before the establishment of a business relationship or the carrying out of the transaction.

Article 30 of the Directive contains rules on the beneficial ownership information that must be collected. All corporate and other legal entities are obliged to obtain and hold adequate, accurate and current information on their UBO, including details of the beneficial interests held (as per article 30(1) of that Directive).

Besides information about the legal owner, they must also obtain and hold information about the UBO, as well as provide such information to entities taking customer due diligence measures (as per article 30(1) of that Directive).

Finally, Member States must set up a register in which the relevant information is kept (as per article 30(3) of that Directive). At least the name, the month and year of birth, the nationality and the country of residence of the UBO, as well as the nature and extent of the beneficial interest held, must be registered (as per article 30(5) of that Directive).

In addition, companies and individuals are obliged to consult the UBO Register when performing anti-money laundering due diligence.

Non-compliance with the UBO obligations can result in significant penalties. The maximum administrative penalty is at least twice the amount of the benefit derived from a breach of the obligations, where that benefit can be determined, or at least EUR 1 million. For credit and financial institutions, higher sanctions apply, equal to a maximum of EUR 5 million or 10% of the total annual turnover according to the latest available accounts. For individuals, the maximum penalty is EUR 5 million or the equivalent in national currency on 25 June 2015.

4.2.3. Mandatory disclosure

The latest disclosure measure which has big impact on tax advisors and their clients concerns mandatory disclosure of tax information. On 25 June 2018, the Mandatory Disclosure Directive (2018/822)⁴⁹ was adopted, obliging tax advisors and other intermediaries to report aggressive tax planning structures to the tax authorities. The Mandatory Disclosure Directive must be implemented by 1 July 2020, and initial information must be exchanged by 31 August 2020.

The impact of this Directive follows from its strict main goals, being:

1) to obtain information in order to reduce the knowledge deficit of the legislator, as tax planners are always one or more steps ahead;

⁴⁹ Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139, EU Law IBFD.

2) to reduce the same knowledge deficit of the tax administration, contributing also to risk management; and

3) to provide a deterrent effect to change the behaviour of taxpayers and of their intermediaries.

The information required by the Directive does not have to be disclosed by the companies themselves, unless they develop a structure of tax advice in-house instead of using tax advisors. The Directive implies that companies have to carefully monitor the structures in which they want to become involved. The scope of the information required by the Mandatory Disclosure Directive includes all taxes, except VAT, excise and customs duties and social security contributions.

The Directive not only covers structures resulting in a tax reduction, but also structures aiming to hide the UBO, or trying to avoid the reporting of financial account information.

The reportable structures are identified by means of hallmarks, which indicate the potential risk of tax avoidance. Examples of these hallmarks are the use of substantially standardized structures, deductible cross-border payments to associated companies where the recipient benefits from certain tax advantages (such as a low corporate income tax rate or a preferential tax regime), transfer pricing arrangements involving the use of unilateral safe harbour rules and arrangements designed to circumvent automatic exchange of information and beneficial ownership.

The structures concerned must also meet a main benefit test, which implies that it must be determined if the main benefit or one of the main benefits that are expected to be obtained by its beneficiary, relate to a tax advantage. A major problem deriving from this test is that no guidelines exist and, as such, there is a risk of differing interpretations amongst the Member States.

With regard to the hallmarks, the following types are distinguished:

1) generic hallmarks linked to the main benefit test, which may include:

- a) an arrangement where the relevant taxpayer or a participant in the arrangement undertakes to comply with a confidentiality condition;
- b) an arrangement where the intermediary is entitled to receive a fee, which depends on the amount of the tax advantage derived or on the advantage being obtained;
- c) the use of standardized documentation;

2) Specific hallmarks linked to the main benefit test, including:

- a) acquiring a loss-making company through contrived steps, followed by discontinuing the main activity of such a company and using its losses in order to reduce its tax liability;
 - b) an arrangement resulting in the conversion of income into a lower-taxed type of revenue; and
 - c) circular transactions resulting in the round tripping of funds;
- 3) Specific hallmarks related to cross-border transactions, some of which are linked to the main benefit test. This category includes deductible cross-border payments made between two or more associated enterprises if:
- a) the recipient is not resident in any jurisdiction;

b) the beneficiary is resident in a country that does not impose a profit tax, or is a low-tax or an EU blacklisted country⁵⁰;

c) the beneficiary benefits from an exemption; or

d) the beneficiary benefits from a preferential tax regime.

Other structures belonging to this category include:

a) structures where the same asset is subject to depreciation in two or more Jurisdictions;

b) structures where relief from double taxation is claimed in different jurisdictions in respect of the same item of income or capital; and

c) arrangements that involve transfers of assets where the consideration paid is far too low.

4) Specific hallmarks concerning automatic exchange of information and beneficial ownership. This category covers:

a) arrangements designed to circumvent automatic exchange of financial account and beneficial owner information; and

b) specific hallmarks concerning transfer pricing, applicable to, namely:

1) arrangements involving the use of unilateral safe harbour rules;

2) arrangements regarding the transfer of hard-to-value intangibles; and

3) arrangements concerning an intra-group cross-border transfer of functions, and/or risks, and/or assets, where the transfer results in a decline of 50% or more of the projected EBIT in the transferring jurisdiction, over a period of 3 years.

A major problem deriving from using these hallmarks is that they are not always very clear and, therefore, may become vulnerable to a different interpretation by the various Member States.

The Commission has based the use of hallmarks on the argument that it would be impossible to define aggressive tax planning. The Commission, however, may have overlooked that a definition was included in the EC Recommendation of 6 December 2012 C(2012) 8806 final, defining aggressive tax planning as “*taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability*”.⁵¹

Another key aspect of the Directive concerns automatic exchange of information, which is based on the EU Common Communication Network (CCN) and contains guarantees that the Commission will not have access to personal data.⁵² The information must be submitted

⁵⁰ The list currently includes American Samoa, Belize, Dominica, Fiji, Guam, Marshall Islands, Oman, Samoa, Trinidad and Tobago, United Arab Emirates, US Virgin Islands and Vanuatu. Source: <https://www.consilium.europa.eu/en/press/press-releases/2019/05/17/taxation-aruba-barbados-and-bermuda-removed-from-the-eu-list-of-non-cooperative-jurisdictions/>.

⁵¹ European Commission, Commission Recommendation on aggressive tax planning, C(2012) 8806 final (6 Dec. 2012).

⁵² DG Taxation and Customs Union, DPO-3318.3 CCN user management of 11 July 2014, available at <http://ec.europa.eu/dpo-register/detail/DPO-3318-3>. CCN (Common Communication Network) is a network developed and operated by DG TAXUD to support common policies in the area of customs, excise and taxation. It offers all national administrations a coherent, robust and secure method of access to all DG TAXUD applications.

within a short period of 30 days. In this area, the Directive creates an imbalance, as the tax administration is not obliged to disclose internal documents concerning taxpayers.

To avoid a situation in which tax administrations become overwhelmed with information, some Member States want the scope of information restricted.

5. Conclusions

Due to the economic crisis and several tax scandals which came to light shortly afterwards, the G20 called for measures to strengthen the tax base and protect tax revenue. In response, the OECD BEPS measures and the EU Tax Avoidance Directives were introduced. This was logical as a revenue increase can only be realized by means of a joint action of various states and not by unilateral measures which do not result in an equal level playing field. However, the progress at OECD level is behind expectations because so far only an agreement on a few minimum standards was reached, while the rest are only recommendations. Moreover, these recommendations do not fix the underlying problem of BEPS that the domestic corporate income tax systems originate from a time where a substantial part of the trade took place internally. Instead they attack some symptoms in the form of artificial tax-planning arrangements using the differences in tax systems. As a result, it will no longer be possible for multinationals to shift their functions assets and risks to low-tax countries in an artificial manner.

The EU took a two-track strategy. BEPS was combated by tax Directives addressing tax avoidance and profit shifting because these are binding. However, those Directives also contain many options because a compromise had to be reached. The measures included combat several cases of base erosion. Tax planning possibilities, however, remain because significant differences in the tax rates and the calculation of the taxable base within the Member States still exist. Besides, it has to be seen if the Directive terminology will be interpreted in the same manner by all Member States. This bears the risk of inconsistent application among the EU Member States and may, consequently, result in unintended competition distortions. Therefore, better control mechanism seems necessary than only a review after 3 years. The three main aims mentioned in the preamble, i.e. (i) to ensure effective taxation where profits are generated with common anti-avoidance rules applicable in all Member States; (ii) the promotion of a level playing field in the single market; and (iii) the avoidance of risk of double taxation are at all events not met.

In addition, the EU aimed at creating more transparency, inter alia, through an exchange of cross-border tax rulings, the mandatory disclosure Directive on cross-border tax structures and the Ultimate Beneficial Owner information. Finally, to prevent exploiting differences in tax rates, tax objects and tax subjects also the State aid tool is often invoked during the past years.

In a dynamic world with lots of cross border-transactions and cross-border tax planning it is understandable that tax administrations support an increased exchange of data for the application of the domestic tax systems and to prevent future tax avoidance scandals.

However, in order to keep the procedures efficient and to balance the need to obtain information against the administrative burden on companies the obligations should remain proportionate.

The various disclosure obligations have resulted in duplications and result in a disproportionate administrative burden. The disclosure mechanisms do also not consider that sometimes information is difficult to obtain. Furthermore, the criteria used in the Mandatory Disclosure Directive are vague, which may result in differences in interpretation. Finally, all duplications include the risk that the tax administration will drown in irrelevant information.

When examining the proportionality, it should be taken into consideration that through the combination of already existing measures such as the Country-by-Country reports, the exchange of tax rulings and the Multilateral Convention on exchange of information a lot of useful information is already available.

A last aspect where the proportionality is particularly questionable concerns the requesting of personal information concerning the beneficial owners of corporate structures and, moreover, making that information publicly available.

It must be acknowledged that at the level of both the OECD and the EU a lot of steps are taken to combat BEPS. However, in order to really terminate BEPS and to create an equal level playing field not only some symptoms, but also the underlying causes need to be addressed.

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