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Recent proposed amendment of the Parent-Subsidiary Directive COM(2013) 814

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20 January 2014



Problem

The Member State of the parent company does not (fully) tax a distribution of profit that is deductible by the subsidiary

Shortcoming of the current PSD

Wording

“Article 4

1. Where a parent company (...), by virtue of the association of the parent company with its subsidiary, receives distributed profits, the Member State of the parent company (...) shall, except when the subsidiary is liquidated, either:

- a) refrain from taxing such profits;
- b) tax such profits while authorising the parent company (...) to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary (...).”

Shortcoming of the current PSD

Obligation to grant exemption/credit?

Wording -> ambiguous

Purpose/context

“3. The objective of this Directive is to exempt **dividends and other profit distributions** paid by subsidiary companies to their parent companies from withholding taxes and to **eliminate [economic] double taxation** of such income at the level of the parent company.”

Explanatory memorandum to the proposal

“In the PSD (..) Member States are obliged to exempt from taxation profit distributions received by parent companies from subsidiaries of another Member State. This is the case even if the profit distribution as been treated as a tax deductible payment in the Member State where the paying subsidiary is resident.”

Proposed amendment

Wording

“Article 4

1. Where a parent company (...), by virtue of the association of the parent company with its subsidiary, receives distributed profits, the Member State of the parent company (...) shall, except when the subsidiary is liquidated, either:

"a) refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary of the parent company; or

b) tax such profits while authorising the parent company (...) to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary (...).”

Proposed amendment

Explanatory memorandum and preamble

Commentary to Article 4:

“The Member State of the receiving company **shall therefore tax** the portion of profits that is deductible in the source Member State.”

Third recital of proposed amended preamble:

“For the purpose of avoiding situations of double non-taxation deriving from mismatches in the tax treatment of profit distributions between Member States, the Member State of the parent company and the Member State of its permanent establishment **should not allow those companies to benefit from the tax exemption** applied to received distributed profits, to the extent that such profits are deductible by the subsidiary of the parent company

Proposed amendment

Obligation or right?

Does Article 4(1)(a) imply an **obligation** to non-exemption (hence taxation) to the extent that a profit is not deductible by the subsidiary?

Or does **obligatory** taxation ensue from Artikel 4(1)(b)?

-> **fundamental change of character of that provision:**

from prevention of **double taxation** to (also) prevention of **double non-taxation**

Or does Article 4(1)(a) only imply a **right** to combat double non-taxation?

Proposed amendment

J. Cruijff: “If I wanted you to understand, I would have explained it better”:

“(c) tax such profits to the extent they are deductible by the subsidiary of the parent company”

Proposed amendment

How does the ECJ interpret directive provisions?

ECJ predominantly considers **wording** and **context**: (a.o.)

- **C-284/06, 26 June 2008, *Burda***
- **C-48/07, 22 December 2008, *Vergers du Vieux Tauves***
- **C-247/08, 1 October 2009, *Gaz de France***

“Logical” outcome based on objective does not automatically prevail

Travaux préparatoires are irrelevant: (**C-375/98, 8 June 2000, *Epson Europe BV, § 26***)

Shortcomings of the proposed PSD

Prevention of hybrid financing is confined to scope of PSD:

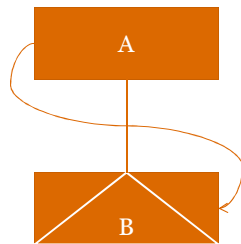
- Min. 10% shareholding
- EU legal form
- EU resident

Obligation on parent company does not affect payments by EU subsidiary to non-EU parent company!

Hybrid financing to hybrid subsidiary still seems to work ->

Shortcomings of the proposed PSD

Hybrid financing to hybrid subsidiary



Article 4(2) PSD

Parent company is allowed to tax profits of 'hybrid' subsidiary, if exemption or credit

Exemption not linked to 'non-deductibility' by subsidiary

Still full exemption?

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What's next?

Consultation procedure: adoption by Council (unanimity), consultation EP

-> alternative: enhanced cooperation?

Until adoption PSD-> no changes

After adoption PSD -> until 1 January 2015:

- Member States are allowed to take measures earlier
- Without domestic implementation measure, not possible to rely on directive to the detriment of taxpayer (wording 'old' directive gives right to exemption/credit and principle of legal certainty)

After 1 January 2015 -> Commission will start infringement procedures against non-compliant Member States

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What's next

Political will?

25 May 2010 – Code of Conduct Group: agreement on solution

March 2012 – European Council Conclusions: “rapidly develop ways to improve the fight against tax fraud and tax evasion.”

19 April 2012 – EP Resolution: “calls for a review of the Parent-Subsidiary Directive and the Interests and Royalties Directive in order to eliminate evasion via hybrid financial instruments in the EU.”

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What's next

Political will?

6 December 2012 – EC Action Plan: “(..) legislative amendment of the Parent Subsidiary directive. The objective will be to ensure that the application of the directive does not inadvertently prevent effective action against double non-taxation in the area of hybrid loan structures”.

21 May 2013 – EP Resolution: “calls on the Commission to address specifically the problem of hybrid mismatches between the different tax systems used in Member States”

22 May 2013 – European Council Conclusions: “[t]he European Council agreed to accelerate work in the fight against tax fraud, tax evasion and aggressive tax planning.”

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What's next

Political will?

FT 25-11-2013 “likely to hit a wall of objections from a minority of countries that could hold up the reforms. Diplomats involved expect Luxembourg, and perhaps the Netherlands, to raise concerns.

Even if the proposal was entirely uncontroversial, it would have difficulty passing before next year’s European elections, which usher a new set of policy makers into Brussels’ institutions.”

It's the end of the (hybrid) world as we know it..

Member States: room for manoeuvre is limited:

- Infringement procedure by EC
- Pressure from OESO (BEPS)
- Code of Conduct Group
- State Aid

Taxpayers: is hybrid planning still **desirable**?

Thank you...

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