EUROPEAN COMMISSION
Impact Assessment Board

Brussels,
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Opinion

Title **Impact Assessment on amendments to the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast)**

(draft version of 19 July 2013)*

(A) Context

The Action Plan to strengthen the fight against tax fraud and tax evasion adopted by the Commission of 6 December 2012 (COM (2012)722) prioritises addressing clear mismatches between Member States' tax systems. Since 2009 the distorting effects of mismatches resulting from differences in the tax treatment of hybrid loans, especially profit participating loans (PPL) between Member States have been discussed in the context of the Code of Conduct Group. Hybrid loans were treated by some Member States as equivalent to simple loans, and by others as a form of equity capital, which implied that payments under a cross-border PPL can be treated as a tax deductible expense in the source Member State and as a tax exempt distribution of profits (dividend) in the recipient Member State, which results in double non-taxation. This deprives Member States of significant revenues and creates unfair competition between businesses in the Single Market. Public consultation on double non-taxation in 2012 showed that mismatches between countries' qualification of hybrid financial instruments and hybrid entities were found the least acceptable double non-taxation issue. The Action Plan also called for a review of the anti-abuse provisions of the Directives on Parent-Subsidiary, with a view to implement the principles underlying its Recommendation on aggressive tax planning. This is also addressed in the current analysis.

(B) Overall opinion: POSITIVE

The report gives a good overview of the main issues that the initiative aims to address. It should be further strengthened in the following respects. Firstly, the report should better indicate the extent of the problem, i.e. that some companies are currently not taxed on realised profits, because of the existence of loopholes related to hybrid financing in cross-border situations. Secondly, the explanation of the proportionality of the options should be strengthened in view of the critical comments received from some Member States and stakeholders. Thirdly, the report should compare the options on the criteria of effectiveness, efficiency and coherence in achieving the objectives.

In their written communication with the Board DG TAXUD agreed to amend the report along the lines of these recommendations.

* Note that this opinion concerns a draft impact assessment report which may differ from the one adopted

(C) Main recommendations for improvements

(1) Better indicate the scope of the initiative. The report should explain that although it is difficult to provide a quantitative assessment of the extent of the problem, there is an increased awareness of the problem with hybrid instruments in Member States' tax administrations and international organisations. The increased level of sophistication in the structuring of financial cross-border transactions poses important challenges to tax revenue authorities and tax policy makers. The report should better emphasise that the objective of the initiative is that all companies are taxed on the realised profits in the EU Member State concerned and that companies cannot escape taxation by exploiting loopholes from hybrid financing in cross-border situations, and explain clearly that in this context further quantification would not be proportionate. The arguments surrounding the inclusion of a General Anti-Abuse Rule (GAAR) in this Directive should be strengthened, by referring to input received from stakeholders and interpretation issues concerning ECJ jurisprudence. As regards the relevance of this initiative for SMEs it should explicitly state that although SME representatives were consulted, no objections were raised from their side.

(2) Discuss the proportionality of the options in more detail. The report should strengthen the explanation of the proportionality of the options, in view of the critical comments received from some Member States and stakeholders. It should better demonstrate why options A1 and B1 are not sufficiently effective, by clearly explaining that non-implementation by one Member State will affect other Member States, and that the mismatch loophole will only be closed if all Member States tax the profits which are deductible in the source state. With regard to GAAR the report should clearly explain that non-implementation by one Member State will affect other Member States as investments are likely to be channelled through Member States with the weakest anti-abuse provisions. Finally it should more clearly state that business objections against restrictions on the use of PSD are at least partly motivated by the desire to retain tax planning opportunities, which is in clear opposition with the objective of having clear and coherent anti-abuse tax rules across the EU.

(3) Improve the comparison of the options. The options should be compared on the basis of the criteria of their efficiency and effectiveness in achieving the objectives, and their coherence with other relevant policies. It should explain why on some issues stakeholder positions had to be rejected.

Some more technical comments have been transmitted directly to the author DG and are expected to be incorporated in the final version of the impact assessment report.

(D) Procedure and presentation

The report should state more explicitly how the PSD is and will be monitored. It should include a short summary of the inter-service steering process that led to the draft impact assessment. It should also include a separate paragraph explaining how the recommendations in the Board's opinion were taken into account in the final version.

(E) IAB scrutiny process	
Reference number	2013/TAXUD/005
External expertise used	No
Date of IAB meeting	Written procedure.