

EC amendments to Parent Subsidiary Directive address hybrid loans and introduce common GAAR

November 27, 2013

In brief

On November 25, 2013, the European Commission (EC) proposed amendments (2011/96/EU) to the Parent Subsidiary Directive (PSD) to address tax fraud and evasion as well as aggressive tax planning and base erosion and profit shifting (BEPS) in the European Union (EU). The proposal addresses hybrid financial mismatches under the PSD and introduces a general anti-abuse rule (GAAR) to protect the directive's functioning.

In detail

The proposal follows the political guidance agreed in 2009 within the EU's Code of Conduct Group. The Group agreed to use business taxation to address the distorting effects of mismatches resulting from differences in the tax treatment of hybrid loans (PPLs) between EU Member States. The proposal allows domestic tax law to implement this political guidance. If the EU member states adopt the EC's proposal, Art. 4(1)(a) of the PSD would provide that where a parent company, by virtue of its association with its subsidiary, receives distributed profits, the parent company's Member State shall refrain from taxing such profits to the extent that such profits are not deductible by the parent company's subsidiary.

The EC also proposes to replace the current anti-abuse provision in the PSD by inserting a common GAAR, based on the similar clause included in its December 6, 2012 ATP Recommendation.

Under the main amendments:

- The PSD shall not preclude the application of domestic or agreement-based provisions regarding tax evasion
- EU Member States shall withdraw the benefit of the PSD in the case of an artificial arrangement or an artificial series of arrangements put into place for the essential purpose of obtaining an improper tax advantage under the PSD and which

defeats the object, spirit and purpose of the tax provisions invoked

- A transaction, scheme, action, operation, agreement, understanding, promise, or undertaking is an artificial arrangement or a part of an artificial series of arrangements where it does not reflect economic reality
- In determining the artificiality, EU Member States shall ascertain whether one or more of the following situations are involved:
 - a) the legal characterisation of the individual steps which an arrangement consists of is inconsistent

- with the legal substance of the arrangement as a whole
- b) the arrangement is carried out in a manner not ordinarily used in a reasonable business conduct
- c) the arrangement includes elements having the effect of offsetting or cancelling each other
- d) the transactions concluded are circular in nature
- e) the arrangement results in a significant tax benefit which is not reflected in the business risks undertaken by the taxpayer.
- Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by December 31, 2014.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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