Global Tax Policy
Alert

European Commission's Tax Omnibus proposes significant ATAD amendments

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In brief

What happened?

The European Commission has published a Tax Omnibus proposal that would amend, among other Directives, the first Anti-Tax Avoidance Directive (ATAD). The Tax Omnibus is released alongside a separately proposed DAC Recast. The DAC Recast changes are covered in this tax policy alert.

This alert focuses on the ATAD changes; non-ATAD direct tax measures (the Interest and Royalties Directive, Parent Subsidiary Directive, FASTER, Merger Directive, and Dispute Resolution Mechanisms Directive) are addressed in a companion alert, available via this link. The ATAD amendments are among the most significant elements of the package and would introduce changes to the interest limitation rule (ILR), controlled foreign company (CFC) rules, the general anti-abuse rule (GAAR), and hybrid mismatch rules. The proposal also would introduce a new EU-wide research and development (R&D) allowance within the ATAD framework.

Why is it relevant?

The ATAD amendments address longstanding concerns about the complexity and fragmentation of EU anti-avoidance rules. Since the implementation of Pillar Two, certain ATAD provisions - particularly CFC rules - have created overlapping obligations and potential double taxation for multinational groups. The proposal seeks to eliminate these overlaps, simplify the ILR, introduce a harmonised R&D incentive, broaden the GAAR, and remove the complex imported hybrid mismatch rules.

Actions to consider

According to the Commission's impact assessment, the ATAD-specific measures could generate substantial compliance and financial savings for businesses: combined CFC rule changes are expected to total EUR 250 million per year in savings, ILR rules approximately EUR 500 million per year, and the immediate expensing of R&D assets around EUR 265 million per year. Businesses should assess the changes to determine the effect on interest deduction capacity, CFC obligations, R&D investment planning, and the overall impact on tax compliance. Business should also be mindful that agreement to this tax omnibus requires unanimous support from all 27 EU Member States.

In detail

Interest Limitation Rule (ILR)

The proposal would make the 30% of EBITDA threshold mandatory, set the (now mandatory) de minimis safe harbour at EUR 3 million, phased in within three years and indexed annually. The standalone entity exclusion would be removed, given the new safe harbour and third-party loan carveout.

Low-risk third-party loans would be excluded where they are not from associated enterprises and fund the borrower's own activities. The proposal would also mandate the availability of the group escape rule and carryforward mechanisms, broaden the long-term public-benefit project exclusion, add a procyclicality safeguard for significant (50%) EBITDA drops, and temporarily exclude certain defence-related borrowing costs.

Observation: The ILR changes represent helpful simplifications and should benefit capital-intensive sectors, real estate groups, and start-ups that rely on long-term debt financing. The mandatory 30% threshold eliminates fragmentation across Member States that had applied lower percentages. While businesses will welcome the obligatory roll out of the de minimis threshold safe harbour, the decision to retain the EUR 3 million threshold, rather than increase it to EUR 5 million as had been discussed, may limit the extent of simplification for some businesses.

The third-party loan carve-out is potentially transformative for groups with substantial external financing, though the condition that loans must not be used for on-lending or funding equity contributions will require some consideration. The defence exclusion reflects EU geopolitical priorities but is narrowly scoped and time-limited. The broadening of the long-term public-benefit project exclusion is welcome, but its scope remains vague and therefore, it is yet to be seen how Member States will implement it in practice.

Controlled Foreign Company (CFC) Rules

Article 4 of the proposal would exempt EU companies falling within the scope of the Pillar Two Directive from CFC rules for low-taxed subsidiaries. The carve-out would not apply where the Ultimate Parent Entity (UPE) is in a qualified side-by-side regime jurisdiction and the CFC is not subject to a Qualifying Domestic Minimum Top-Up Tax (QDMTT), or where a QDMTT is offset by a refund or financial benefit. Another new exemption would remove SMEs and qualifying standalone micro, small, and medium-sized undertakings (with a foreign branch) from CFC rules.

The proposal also would modify the framework by removing the option to implement CFC rules through the so-called 'Model B' ('transactional' approach which focuses on artificial tax-avoidance arrangements

and transactions), making 'Model A' ('entity' approach targeting specific types of passive income) the sole permitted income attribution approach, and by mandating the one-third passive income threshold.

Observation: The CFC carve-out for Pillar Two groups is a welcome step in addressing the overlap between CFC rules and the global minimum tax. However, the limitation for groups with UPEs in side-by-side regime jurisdictions (currently only the United States) means that US-parented multinationals with EU subsidiaries may not fully benefit unless their CFCs are subject to a QDMTT. This could create asymmetry between EU-parented and US-parented groups or produce unwelcome outcomes for Member States without QDMTTs in place.

The SME exemption should provide meaningful relief, as anecdotal evidence from Member States indicates that CFC rules have rarely been triggered for smaller businesses. The removal of Model B would simplify compliance, but the proposal is silent as to how this should be adopted by the Member States already using Model B for income attribution.

R&D Allowance (New Chapter in ATAD)

The proposal would introduce a new EU-wide R&D immediate expensing regime as a minimum standard within the ATAD framework. Taxpayers would be entitled to full deductibility of qualifying capital expenditure on plant, machinery, and other tangible assets used directly for R&D or to provide R&D facilities. The allowance may be claimed in the tax period in which the expenditure is incurred or spread over any of the four subsequent tax periods. Adjustments to the EBITDA calculation would ensure that the R&D allowance does not reduce a taxpayer's interest deduction capacity under the ILR.

Observation: The R&D allowance addresses the fragmented landscape of R&D tax incentives across Member States and aims to ensure that EU businesses are not at a competitive disadvantage internationally, particularly given the favourable treatment of R&D incentives under the Pillar Two framework. However, the scope is limited to capital expenditure on tangible assets—it does not cover staff costs, consumables, or intangible R&D inputs, which are often the largest R&D cost components. Businesses should assess how the new EU minimum standard would interact with or supplement existing national R&D regimes, including R&D tax credits and patent boxes. The anti-abuse provisions, including a three-year minimum use requirement and balancing charge mechanics on disposal, will need to be factored into asset acquisition and lifecycle planning.

GAAR and Hybrid Mismatch Rules

The proposal would broaden the scope of the GAAR to apply consistently to all direct taxes to which companies may be subject, including withholding taxes and Pillar Two top-up taxes. Separately, the rules on imported hybrid mismatches would be removed entirely. The Commission considers that these rules have proven excessively complex.

Observation: The broadening of the GAAR to withholding taxes and Pillar Two top-up taxes is a significant development that confirms Member States' ability to challenge abusive arrangements across all direct tax instruments. Businesses should review whether existing structures could be affected by the expanded scope. The removal of imported hybrid mismatch rules is a practical simplification that will be welcomed by taxpayers and advisors who have struggled with the complexity of tracing mismatches through multi-layered group structures. However, the primary and direct hybrid mismatch rules in Articles 9(1) and 9(2) would remain in force, and Member States may retain or introduce domestic rules addressing similar concerns.

What's next?

The proposal requires unanimous agreement in the Council of the EU and remains subject to negotiation and amendment during the legislative process. The European Parliament must be consulted, although its opinion is not binding. The draft directive includes placeholder transposition and application dates (1 January 2029). Notably, several ATAD measures would have deferred or time-bound application. For example, the de minimis safe harbour from ILR will not be fully rolled out until 2032, and the defence sector exclusion would be limited to the first five tax years after entry into force.

Observation: Initial reactions from Member States suggest that negotiations may prove difficult. A number of Member States face significant fiscal budgetary pressures that might make it harder for them to support measures that could reduce revenues relating to ATAD measures and withholding tax revenues, even where the long-term competitiveness case is strong. Germany has raised structural concerns, questioning whether simplification of the direct tax framework risks reopening broader tax avoidance discussions that Member States had considered settled following the adoption of ATAD and Pillar Two. It is noteworthy that the Irish Presidency of the Council of the EU (beginning 1 July) will aim to 'progress work' on the omnibus, but not to set the goal of agreeing the package before the end of the calendar year (unlike the DAC Recast which is intended to be agreed by then). The unanimity requirement in Council could prove a significant obstacle to achieve the simplifications, and the final text - if agreed - may look materially different from what the Commission has proposed.

Businesses should monitor the legislative process closely and, in parallel, review their CFC compliance frameworks, interest deduction capacity, R&D investment structures, and hybrid mismatch positions in light of the proposed changes.

Let's talk

For a deeper discussion of how the proposed measures might affect your business, please contact:

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