Global Tax Policy
Alert

European Commission publishes Tax Omnibus proposal – Key potential impacts for the financial sector

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In brief

What happened?

The European Commission has published a Tax Omnibus proposal that would amend six EU direct tax directives: the Interest and Royalties Directive (2003/49/EC), the Merger Directive (2009/133/EC), the Parent-Subsidiary Directive (2011/96/EU), the Anti-Tax Avoidance Directive (ATAD) (2016/1164), the Dispute Resolution Mechanisms Directive (2017/1852), and the FASTER Directive (2025/50).

The package is intended to simplify the EU direct tax framework, reduce compliance burdens, improve legal certainty, and support EU competitiveness. For more details about the Tax Omnibus, please read our Tax Policy Alerts covering the ATAD proposals and the proposals for changing the other Directives. This Alert focuses on measures that are relevant for the financial sector, including the proposed changes to the Interest and Royalties Directive (IRD), Parent Subsidiary Directive (PSD), FASTER, and ATAD.

Why is it relevant?

The proposal introduces significant changes to withholding tax relief procedures, new exemptions and carve outs for existing anti-avoidance rules, and new restrictions to prevent abuse. Whilst many of the changes could be beneficial for companies managing financial and compliance tax costs, there are some changes that could result in further issues for the financial services sector. These are detailed below as observations.

Actions to consider

The proposal requires unanimous agreement in the Council of the EU. It currently is subject to negotiation and amendment during the legislative process. The legislative path may be difficult because several Member States remain sensitive to direct revenue impacts and to any perception that simplification weakens anti-abuse protections. Financial services groups impacted by these proposals should therefore discuss the associated benefits and concerns of the Tax Omnibus with EU Member State tax and treasury departments as soon as possible, so that the full range of consequences is understood.

In detail

The Tax Omnibus proposes removing longstanding barriers to investment such as minimum holding requirements, shifts from prior authorisation to self-assessment with ex post controls, and links IRD/PSD exemptions to FASTER relief-at-source and quick refund procedures for certain types of transactions. 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 Interest Limitation Rule, introduce a harmonised R&D incentive, and remove the complex imported hybrid mismatch rules. Businesses should be aware that the Tax Omnibus also would broaden the General Anti-Avoidance Rule to capture withholding taxes and Pillar Two, and would introduce a new targeted anti-avoidance rule around the payment of interest and royalties.

Interest and Royalties Directive (IRD)

Withholding tax simplification

The proposal would remove the current 25% minimum holding requirement for ‘associated company’ status, allowing withholding tax exemptions on interest and royalty payments regardless of participation level, subject to application of GAAR and beneficial ownership rules. It also would remove the option for Member States to replace the capital participation criterion with a voting rights criterion.

The proposal would clarify that the exemption applies to permanent establishment-attributable payments and would update the annex of eligible company forms. The current prior-authorisation model would be replaced by self-assessment, with FASTER or domestic refund procedures applying where eligibility cannot be confirmed at the time of payment. The FASTER link is framed as a derogation from the standard IRD refund mechanism, improving legal certainty on which procedure takes priority.

Observation: The removal of the 25% holding threshold is a meaningful alignment of the Directive with market needs. It allows, in principle, for financial services groups such as insurance companies (investing their own balance sheet) or asset managers and banks (investing on behalf of their clients or the products they manage) to significantly reduce taxation and compliance burdens for intra-EU investments.

However, the practical benefit will depend on how entitlement to relief is tested, and it remains to be seen whether the amendments will deliver the simplification and compliance relief the Commission is seeking as part of its ambition to implement an EU Savings and Investment Union. There remains a risk that local substantive and procedural approaches to beneficial ownership, documentation, and anti-abuse requirements could limit the effectiveness of the simplification. This risk is particularly relevant for custody banks, investment funds, securities lending counterparties, and other financial market participants operating complex arrangements such as nominee investor arrangements, multi-tier and multi-investor investment structures, which are common in financial services for various commercial and legal reasons. Securities financing participants, banks, and asset managers have called for clear, predictable tax entitlement and consistent, OECD-aligned definitions of beneficial ownership across Member States, precisely because divergent national approaches undermine relief in intermediated holding chains. The link to the FASTER framework is helpful but might not on its own remove operational frictions for private markets and even listed securities. Common binding guidance on beneficial ownership would be helpful.

New anti-avoidance provision

A double non-taxation safeguard would require source states to levy withholding tax or deny a deduction where the recipient is established in a third-country jurisdiction with no or zero corporate income tax on interest and royalty income and no withholding tax is levied at source. This safeguard would not apply where the recipient is subject to a Qualifying Domestic Minimum Top-Up Tax (QDMTT) (without refund or financial benefit) or is part of an MNE group within the scope of the Pillar Two Directive or, for third-country recipients, the OECD Model Rules. However, the safeguard may still apply where the Ultimate Parent Entity (UPE) of the MNE group is in a jurisdiction with a qualified side-by-side regime.

Observation: The double non-taxation safeguard warrants close attention. While the policy goal is to avoid abuse, it could result in a material impact on debt assets and debt instruments. Furthermore, it could make new and already existing debt instruments and investments inefficient tools for capital markets.

Non-EU investors such as taxable investors, sovereign funds, exempt pension organizations, or endowments use investment fund vehicles domiciled in their own jurisdictions or other established and regulated investment fund jurisdictions like the Cayman Islands for commercial reasons (legal, regulatory, etc.) to make investments. As in most countries, these funds are normally exempt to ensure their tax neutrality, but their income and gains are generally subject to appropriate taxation under taxation regimes in the country of residence of the ultimate investor. As investment funds are only exceptionally consolidated, the fund’s income does not account for the tax burden of the US Net CFC Tested Income (NCTI) Rule for groups or QDMTT under Pillar Two.

Where investment funds rely on special purpose vehicles or investment platforms for commercial or legal reasons to make investments, any debt used to fund these vehicles could, as a direct result of this proposal, result in withholding taxes on interest or inefficiencies due to non-deductibility. Because of this proposal, investment managers could favour non-EU investment platforms replacing existing EU investment hubs.

Even where investments are held solely by EU investors, this measure could open the door to disproportionately high compliance costs and inefficiencies in the financial services sector where interest is paid directly or indirectly to, for example, widely held non-EU investment funds, or paid by widely held securitisation vehicles or via instruments that are otherwise not subject to withholding tax in the European Union like ordinary public bonds. As a direct result of this proposal, very common capital markets instruments could become more expensive for the company needing financing due to either the costs of withholding tax (particularly if gross-up clauses apply), administrative burden to deal with withholding tax or refunds thereof, or the cost of interest no longer being deductible. This outcome seems undesirable when the ultimate investor is subject to appropriate taxation or when the ultimate investor is a pension fund.

Parent-Subsidiary Directive

The PSD amendments would broadly mirror the IRD changes. The minimum holding requirement for ‘parent company’ status would be removed, and the option to use a voting rights criterion also would be eliminated. The scope would be extended to pension institutions regardless of legal form. Member States’ option to deny a deduction for participation-related costs would be limited to participations of at least 10% where management costs are actually incurred. Self-assessment would become the default mechanism. The proposal explicitly preserves national anti-abuse measures aimed at preventing the avoidance of wealth or income tax liabilities through the use of holding companies.

The proposal also would introduce standard refund timelines: investors would have at least two years to file a refund claim, and refunds would generally have to be paid within one year, with interest applying if that deadline is missed.

Observation: The PSD changes are particularly relevant for institutional investors and long-term savings capital, including pension institutions that accommodate portfolio investments and minority holdings, commonly used in financial services structures. The proposed extension of the PSD to pension institutions established in the European Union is a welcome change and could improve the dividend withholding tax position of qualifying EU pension organisations receiving dividends from other Member States, provided they are covered by Directive 2003/41/EC and Directive 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORP and IORP II Directives) and Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems. In practice, the main benefit could arise at the level of corporate holding and investment vehicles typically used by private markets funds for legal segregation and other commercial reasons rather than at fund level, as many investment funds could remain outside the Directive's scope.

The benefit of the proposal, however, will depend on local implementation and application of anti-abuse rules raising the same risk of additional compliance burden rather than simplification. Financial services market participants including insurers, asset managers, and custody banks have highlighted that persistent divergences in national interpretation continue to undermine the Directive’s objective of eliminating double taxation, and have sought clarity on beneficial ownership, the anti-abuse rule, participations held through partnerships, and the procedural and residence-certificate aspects – points that bear directly on how reliably the extended scope will operate in practice.

FASTER Directive

The proposal would amend Article 11 of the FASTER Directive so that Member States no longer could deny access to FASTER fast-track procedures—relief at source or quick refund—solely because a full withholding tax exemption is claimed under the IRD or PSD. As a result, investors in publicly traded securities who are entitled to IRD/PSD exemptions still could access these streamlined procedures.

Observation: This proposal is most relevant where publicly traded securities are held through intermediaries or nominee accounts and therefore of particular significance for custodians, brokers, asset managers, withholding tax agents, and other intermediated investment models. The key point is that Member States should not be allowed to exclude such payments from the first-track relief mechanism. Eligibility for relief should instead be assessed through the applicable due diligence process. The FASTER link is expressly framed as a derogation from the standard refund procedures, which should reduce the risk of procedural conflicts between the two frameworks and help create a more integrated EU withholding tax relief system.

If IRD/PSD-exempt payments can still access FASTER relief-at-source or quick refunds, the change could reduce procedural friction, but the practical benefit would still depend on due diligence standards and the evidence needed to support claims, in addition to challenges pointed out above. Documentation flows may need to distinguish between corporate investors, pension funds, other fund, and investment categories.

Anti-Tax Avoidance Directive (ATAD)

Interest Limitation Rule (ILR)

The proposal would make the 30% of EBITDA threshold mandatory and 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 carry forward 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. The definition of financial undertakings to which ILR do not apply has also been updated to reflect developments in Union financial regulation since the adoption of the ATAD.

Observation: For financial services groups, investment funds, and the products and investments they manage, the ILR package could bring helpful change, particularly for real estate companies, as well as operating companies held by private equity funds. The opportunities and impacts that come with these measures would, among others, depend on how the requirement for using the funds for "*the borrower's own activities"* will be implemented and interpreted in practice. The introduction of the low-risk third-party loans exemptions is welcome, but the limited use of the borrowings (excluding intra-group financing and equity contributions into group companies) diverges from common financing realities. This means that the practical utilisation of this exemption could be significantly limited.

Controlled Foreign Company (CFC) rules

Article 4 of the proposal would exempt EU companies falling within the scope of Pillar Two from CFC rules for low-taxed subsidiaries. The carve-out would not apply where the UPE is in a qualified side-by-side regime jurisdiction and the CFC is not subject to a 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 focusing on artificial arrangements), making 'Model A' (entity approach targeting specific categories of passive income) the sole permitted income attribution approach, and by mandating the one-third passive income threshold.

Observation: The Pillar Two carve-out should be welcome for banks, insurers, asset managers, and other groups already managing complex global minimum tax compliance, because it could remove duplicative CFC exposure and local compliance work for some low-taxed subsidiaries. But the side-by-side regime limitation remains important for US-parented financial services groups, and US businesses will need to analyse which CFCs are located in countries without a QDMTT, even though the US NCTI applies.

The move to a mandatory Model A could be difficult for businesses that earn interest, leasing, insurance, or similar income that looks passive in form even when it arises from regulated activity and real substance. The practical realities of moving away from a 'genuine arrangements' approach under Model B would need to be considered for impacted tax authorities and taxpayers. Managers of private markets investment funds located in countries with Model B or elements of Model B (Ireland, Malta, Cyprus, and Luxembourg to name a few) would need to monitor impacts of a switch from Model B to Model A, risking introduction of significantly more compliance burden under Model A.

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 would 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?

Member States would be required to transpose the Directive by 31 December 2028, with general application from 1 January 2029. However, the IRD and PSD scope extensions, self-assessment provisions, and the IRD double non-taxation safeguard would have significantly deferred application from 1 January 2037. Similarly, several ATAD measures would have deferred or time-bound application.

Let’s talk

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

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