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Anti-avoidance amendment to Parent/Subsidiary Directive

The European Commission has drafted a proposed amendment to the Parent/Subsidiary Directive in the interests of closing perceived loopholes.

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The European Commission has been deliberating for some time over the possibility that the Parent/Subsidiary Directive, designed to avoid double taxation on corporate income within the EU, might be offering aggressive tax planners potential for abusing the system. Since the Commission has been unable to assess the scope of the problem, it has come up with two potential abuses, which it wishes to curb by amending the Parent/Subsidiary Directive. The first item of concern is the avoidance of withholding tax on dividends outside the EU. Broadly, a non-EU parent establishes a subsidiary – as a holding company or a subsidiary for asset management in a country offering a nil rate of withholding tax on dividends to be paid abroad. The company then establishes its operation in its country of choice as a subsidiary of the new holding vehicle. This latter – in its extreme form – exists only on paper and uses an automatic forwarding service for official mail. However, dividends to it are free of withholding tax under the directive and their onward distribution is free under domestic law. Thus the EU double tax elimination rules are misused to avoid tax altogether. The Commission suggests curbing this type of abuse by denying withholding tax privileges under the directive to a company with no other business purpose than to hold the shares in the subsidiaries to the overall group tax advantage.

The other Commission proposal concerns “hybrid” finance. A “hybrid” loan in this sense is given to an ailing subsidiary in a tax environment enabling it to claim an expense deduction for the repayments. These repayments are then booked as tax-free income in a country specifying that dividends are *per se* tax-free income in the hands of a corporation. The income is thus untaxed *in toto*. The Commission would amend the Parent/Subsidiary Directive to specify that a dividend received cannot be tax exempt if the payment was a deductible expense in the country of payment.

Keywords

Parent/Subsidiary, anti-avoidance