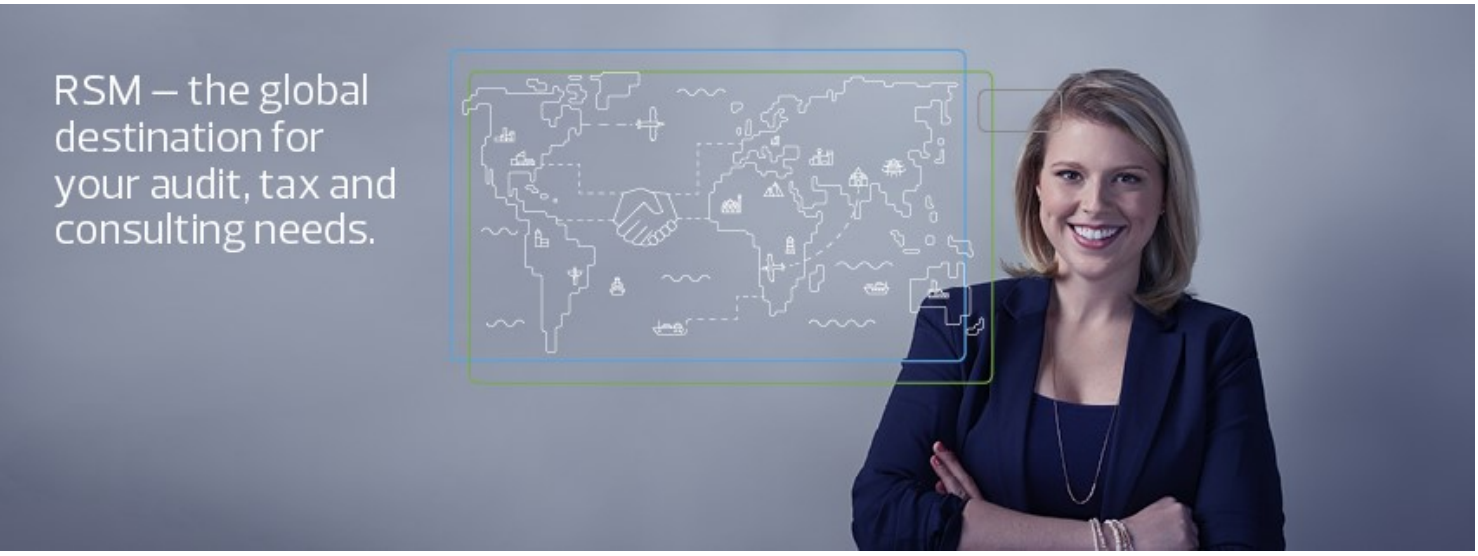


Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market

Tax Alert

Dear Readers,

On 19 July 2016, Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market ("Directive") was published in the Official Journal of the European Union.

As an introduction: a directive is one of the examples of secondary legislation of the European Union (similar to regulation, decision and recommendation, in contrast to the primary legislation, such as a treaty). Usually, the directive serves to harmonise the legal order of member states and can be addressed to one, several or all the member states. Directives are legal acts of special nature, binding on the member states to whom they are addressed. Still, they normally leave the national authorities with a certain amount of leeway as to the legal form and measures to achieve the intended outcome. For this reason, the directive must be implemented into national law. As a rule, the provisions of the directive may not be applied directly. If, however, its provisions are sufficiently precise, it is possible to invoke them where:

- a member state has not implemented the directive, or
- legislation introduced as a result of implementation does not comply with the directive.

The measures targeted by the Directive involve situations where taxpayers act against the actual purpose of the law, taking advantage of the differences between national tax systems, to reduce their tax bill. The Directive lays down anti-tax avoidance rules in the following fields:

- limiting the deductibility of interest;
- exit taxation;
- general anti-abuse rule (GAAR);
- controlled foreign company (CFC);
- framework to tackle hybrid mismatches.

RSM

Limiting the deductibility of interest

The Directive aims to limit the deductibility of net financial costs (i.e. the amount by which financial costs exceed revenues) by limiting the amount of interest from external financing that the taxpayer is entitled to deduct in a tax year. Expenses for net interest will be deductible up to the 30 percent of the EBITDA, or the amount of EUR 3m.

Exit taxation

The Directive contains arrangements for taxation of unrealised increases in value in case of a transfer of assets, moving the tax residence or a permanent establishment. The regulations address situations where taxpayers move their tax residence and/or assets (including unrealised increases in value) to a low-tax jurisdiction. The Directive regulates the taxation of the transferred assets, at the time of exit, less their value for tax purposes, in any of the following circumstances:

- a taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country;
- a taxpayer transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or in a third country;
- a taxpayer transfers its tax residence to another Member State or to a third country;
- a taxpayer transfers its permanent establishment out of a Member State.

A general anti-abuse rule (GAAR)

The GAAR is designed to cover gaps that may exist in a country's specific anti-abuse rules against tax avoidance. It will allow authorities the power to deny taxpayers the benefit of abusive tax arrangements. Under Article 7 of the Directive, non-genuine arrangements carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of otherwise applicable tax provisions will be ignored for the purposes of calculating the corporate tax liability. An arrangement is regarded as non-genuine to the extent that it is not put into place for valid commercial reasons.

Controlled foreign company (CFC) rules

The CFC rules attribute the income of a low-taxed controlled foreign subsidiary to its parent company. As a result, the parent company will be charged tax on this income in its State of residence. The legislation aims to eradicate the incentive of shifting income, so that this is taxed at a low rate in another jurisdiction.

A framework to tackle hybrid mismatches

Provisions dealing with hybrid mismatches aim to neutralise their negative effects which involve, among others, double deductions or a deduction of the income on one side of the border without its inclusion on the other side. In order to ensure effective control of mismatches:

- to the extent that the hybrid mismatch results in double deduction, the deduction is granted only in the Member State in which the payment has its source;
- to the extent that the hybrid mismatch results in deduction without a revenue recognition, the taxpayer's Member State refuses to deduct such payment.

Summary

The Directive will enter into force within 20 days following the date of publication. Following its publication, the Directive must be implemented in the Polish tax law. Under the Directive, Member States must transpose it by 31 December 2018, whereas the provisions should apply from 1 January 2019, except for the provisions concerning:

- taxation of unrealised increases in value, which should be implemented by 31 December 2019 and take effect from 1 January 2020;
- limiting the deductibility of interest, which will come into force after the adoption of similar policies by OECD countries, or at the latest by 2024, whereas the possibility of subsequent implementation of the provisions in question applies only to those Member States that already have national laws aimed at preventing tax base erosion risks and transfer of profits that are as effective as limiting the deductibility of interest specified in the Directive.

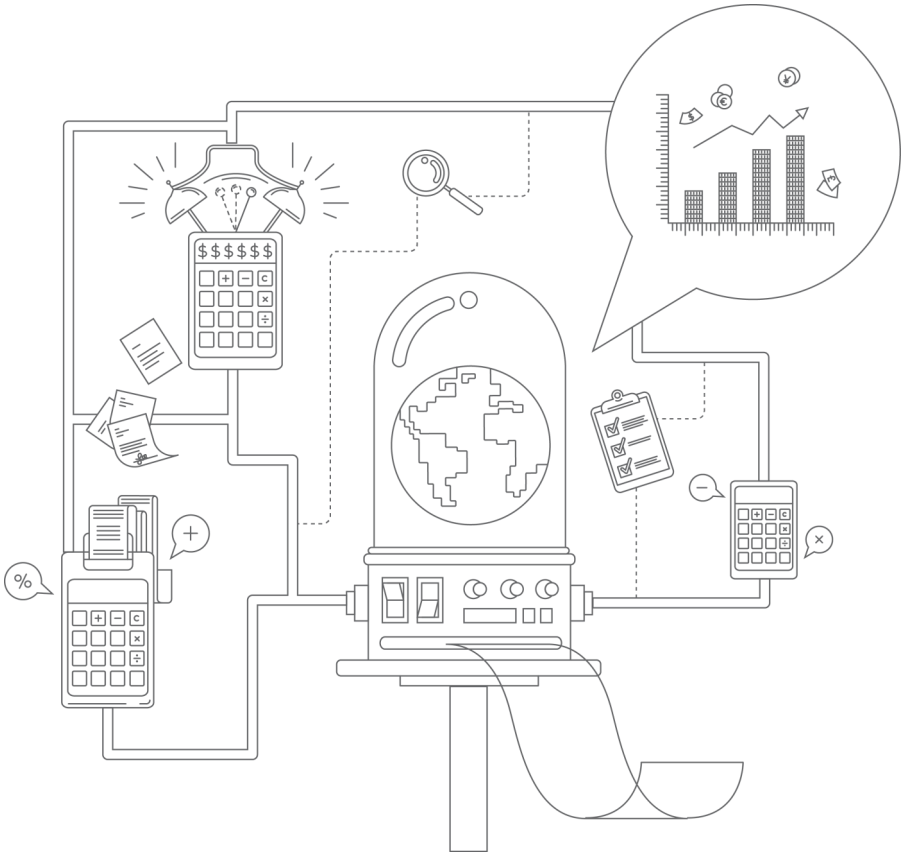
Currently the form in which legislation will be implemented is unknown, considering the fact that Poland has already implemented some of the proposed solutions. We only hope that the legislature will not introduce any overlapping tax clauses. We also hope that the Directive will not delay the work on the introduction of a common consolidated corporate tax base, which should ensure a more fair and effective taxation.

RSM Poland is a member of RSM, the world's 6th largest network of independent advisory and auditing companies, with over 760 offices in more than 120 countries, employing over 38,300 professionals worldwide.

RSM Poland has been operating on the Polish market since 1991. Throughout this time we have gained vast knowledge and experience. We take pride in the unique team of professionals, counting among the best, that we were able to form.

Our company is shaped by our clients, whose requirements always take priority. That is why we offer comprehensive services tailored to meet individual needs. It is our clients who decide about the range of available services, while we give them opportunity for development and growth at every stage of their business.

Years of experience show that our approach is the key to mutual success.



RSM

Should you wish to discuss the above mentioned amendments in detail, feel free to contact us:

Piotr LISS
Tax Partner
Tax advisor (10240)
E: piotr.liss@rsmpoland.pl
M: + 48 696 488 369

RSM Poland
Droga Dębińska 3b
61-555 Poznań, Poland
www.rsmpoland.pl
office@rsmpoland.pl

RSM Poland BLOG

Practical guide to taxes and business.
We invite you to read our publication!

01.08.2016

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM