

EU countries facing BEPS: the case of France

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France



Introduction

- OECD and G20 countries have endorsed an Action Plan to address Base Erosion and Profit Shifting (BEPS)
- France strongly supports the BEPS initiative :
 - major role in pushing forward some topics (digital economy,...)
 - already implemented some of the OECD recommendations
- EU law obligations : specific legal constraints on top of domestic law
- Interactions between EU membership and implementation of BEPS in domestic law / double tax treaties ?

Recall of main features of BEPS

- **B**ase **E**rosion and **P**rofit **S**hifting = « tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid ».
- 15 Actions are being developed in the context of the OECD/G20 BEPS Project = **equip governments with instruments** needed to address this challenge (domestic law level)
- September 2014: publication of first set of reports and recommendations
- October 2015: **coherent package** will be delivered to the G20 Finance Ministers (together with a plan for the follow-up work and a timetable for their implementation)

Recall of main features of BEPS

- Focus on three important reports (OECD's deliverables from 16 September 2014):
 - Action 2: Neutralize **hybrid mismatch arrangements**
 - Action 5: Counter **harmful tax practices**
 - Action 6: Preventing **Treaty Abuse**
- EU is also cooperating extensively by developing new measures → implementation in domestic law!

Recall of main features of EU law

- Obligations deriving from the **EU treaties** (TEU and TFEU) :
 - The four freedoms
 - State aid rules

 - Obligations deriving from **directives** in corporate taxation:
 - Parent subsidiary directive
 - Mergers directive
 - Interests and royalties directive
- BEPS recommendations cannot automatically be transposed in the EU context, as EU Member States must respect EU law obligations !**

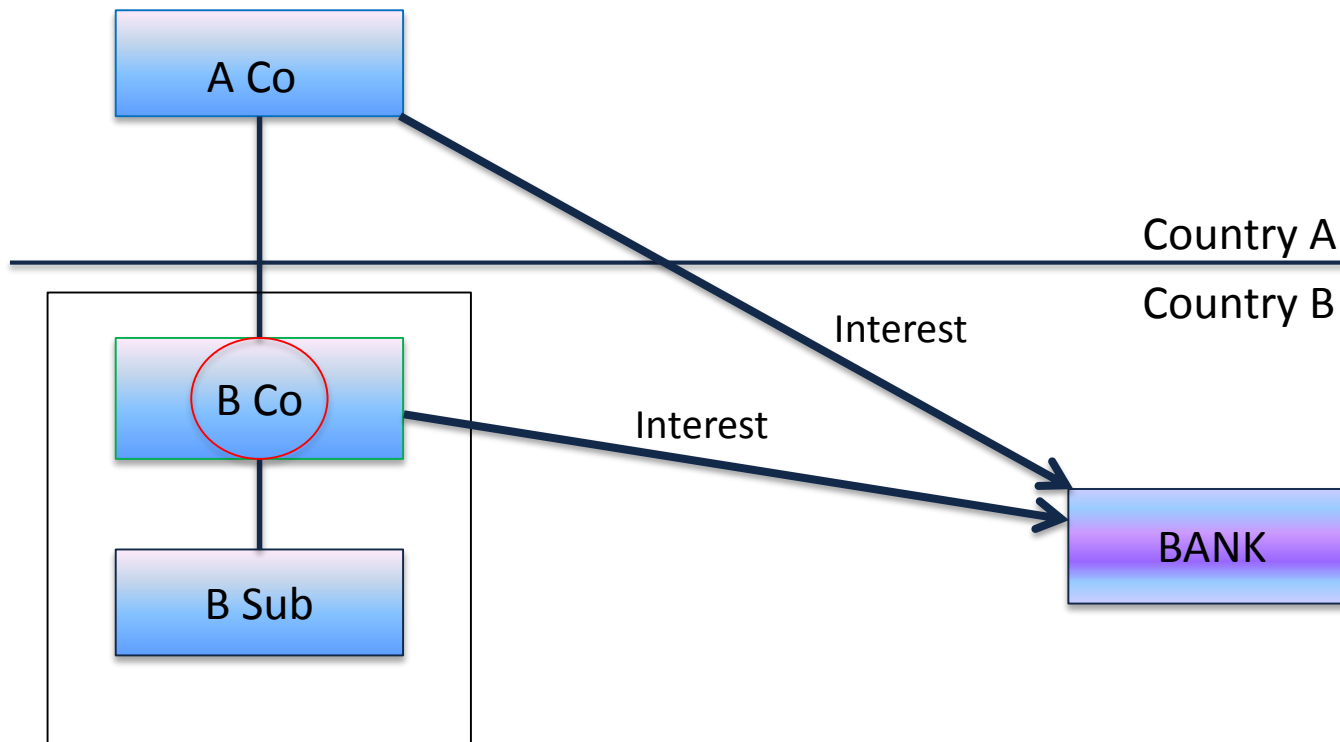
Action 2: Hybrids

1) OECD approach :

- Neutralizing hybrid mismatches = two categories of arrangements:
 - a) Arrangements that involve the use of **hybrid entities** (a same entity is treated differently under the laws of two or more jurisdictions)
 - a) Arrangements that involve the use of **hybrid instruments** (conflict in the tax treatment of the same instrument under the laws of two or more jurisdictions)
- Different characterization => payments that give rise to double deduction or are deductible under the rules of the payor's jurisdiction and not included in the income of the payee

Example:

Double deduction technique using a hybrid subsidiary



Action 2: Hybrids

- **BEPS recommendations** → incorporate a “hybrid financial instrument rule”:
 - Prevention in domestic law of exemption or non-recognition of payments deductible by payor
 - Deny deduction in domestic law for payments that are non-includible in the recipient’s income and not subject to tax under CFC rules
 - Automatic rule : no need for the tax administration to prove a tax benefit or tax avoidance
- **Coordinating rules and consistency of interpretation**

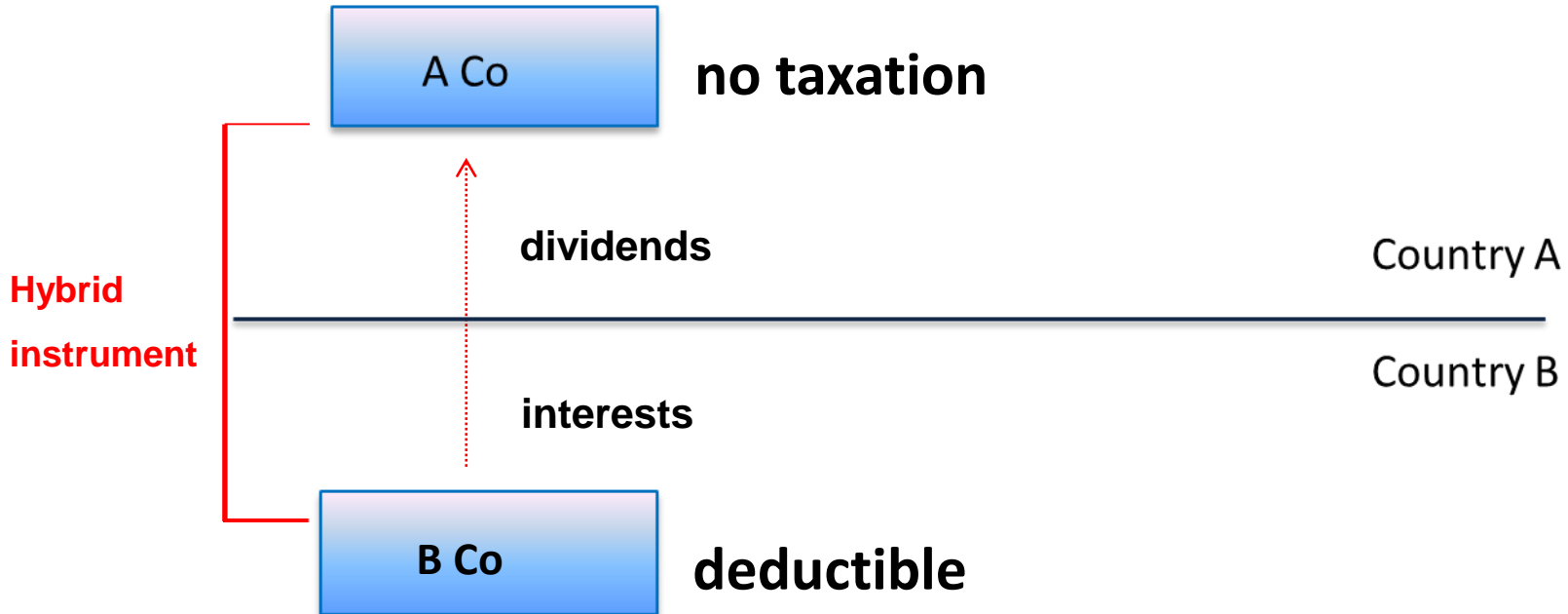
Action 2: Hybrids

2) French initiative :

- Finance Act 2014 → **limitation of deduction of interest paid to hybrid entities** (new anti hybrid provision) : Interest deductions are allowed only if the French borrower demonstrates that the lender is, for the current tax year, subject to corporate tax on the interest income that equals 25% or more of the corporate tax that would be due under French tax rules (*Article 212 I of the GTC*)
- When ? : retrospective application (25 September 2013)
- EU conformity ?

Example:

Double deduction technique using a hybrid instrument



Action 2: Hybrids

3) EU initiative :

- Modification of the EU parent subsidiary directive in summer 2014
- Introduction of a **general anti-hybrid rule**
- New Article 4 (1) (a) : a Member State of a parent company must refrain from taxing profits distributed by qualifying subs of another Member State only to the extent that the distributions are not deductible in the Member State of the sub.

Action 2: Hybrids

2) EU initiative:

- Implementation into domestic law **before January 1st 2016**
- Allows Member States to implement BEPS Action 2 without breaching EU law

Action 2: Hybrids

Implementation in France ?

- Finance Act (December 2014): no exemption if distributed income has been:
 - paid out of profits of an activity that is not subject to CIT or an equivalent tax
 - or
 - deductible for the distributing entity.

Action 2: Hybrids

Implementation in France ?

The French Constitutional Court held that the first section is **unconstitutional** :

- the concept of “activity that is not subject to CIT or an equivalent tax” is too vague
- In particular, it is not clear whether the appreciation would only apply to the sub’s activity or whether the activities of the sub’s subsidiaries (ex. non operational holding) would also have to be subject to CIT (or an equivalent tax)...

Action 5: Harmful tax competition

1) The OECD approach :

- Targeting rulings and administrative practices
 - **Mandatory exchange on rulings**

- Taxation in line with value creation:
 - **Patent boxes**: preferential tax treatment only for IP income generated by qualified expenses incurred by the same taxpayer (modified nexus approach)

Action 5: Harmful tax competition

2) The EU initiative :

○ State aid rules

- TEU prohibits State aid unless it is justified by reasons of general economic development
- Impartial **notification procedure** centralised by Commission:
 - aid measures can only be implemented after approval by the Commission who has also the power to recover incompatible State aid.
- Comparable effect to the OECD obligation of spontaneous exchange on rulings

Action 5: Harmful tax competition

2) The EU initiative :

- State aid rules / infringement procedures :
 - 2014: European Commission decided to **investigate transfer pricing arrangements on corporate taxation** of Apple (Ireland), Starbucks (Netherlands), Fiat Finance and Trade and Amazon (Luxembourg)
 - Tax rulings that are used to provide **selective advantages to a specific company** or group of companies, may involve State aid.

Action 5: Harmful tax competition

2) The EU initiative :

- March 2015: the Commission publishes a draft EU directive on **mandatory exchange of tax rulings**: specific requirement for Member States to automatically communicate information on all their advance cross-border tax rulings and pricing arrangements
- Creation by the Commission of a secure central directory concerning information communicated in the framework of this proposal
- If approved by all Member States → **implementation into domestic law by the end of 2015** (application in January 2016)
- May 2015: the ECOFIN already gave his approval (in an informal context)

Action 5: Harmful tax competition

3) France is not exempt from critics... :

- State infringement procedure against France: **the EDF case**
 - Waiver on tax debts
 - State acting as shareholder vs. State exercising public power
 - “Private investor test”: application in tax matters
- Impact of directive on tax rulings in France ?

Action 6 : Prevention of abuse

1) OECD approach :

- Preventing “treaty shopping arrangements”
- Identification of two cases:
 - a person tries to circumvent limitations provided by the treaty itself
 - a person tries to circumvent the provisions of domestic law using treaty benefits

Action 6 : Prevention of abuse

- **BEPS recommendations** → incorporation of new provisions in DTT's:
 - Preamble : contracting states should state clearly that they intend to avoid tax evasion or avoidance through treaty shopping arrangements
 - Specific anti-abuse rule (based on the „LOB rule“ or SAAR) aimed at treaty shopping
 - General anti-abuse rule (“the PPT rule” or GAAR) aimed at arrangements one of the main purpose of which is to obtain treaty benefits

Action 6 : Prevention of abuse

2) The EU initiative :

- Anti-abuse provision in merger directive
- Anti-abuse of EU law concept in case law (ECJ) :
 - **Halifax 2006** (VAT): two conditions must exist for the abuse to be found:
 - transactions that result in the accrual of a tax advantage the grant of which would be contrary to the purpose of EU law
 - objective factors show that the essential aim of the transactions is to obtain a tax advantage
 - **Cadbury Schweppes 2006** (direct tax/CFC) = “wholly artificial arrangements” are synonymous of abuse

Action 6 : Prevention of abuse

2) The EU initiative :

- What is new ? Introduction of a **specific EU GAAR:**
 - December 2012: European Commission recommends introduction of specific EU GAAR rule
 - January 2015: modification of parent subsidiary directive in order to incorporate a GAAR rule
 - “Essential purpose” vs. “the main or one the main purposes”
 - Objective analysis of “all relevant facts and circumstances” while defining “not genuine” arrangements

Action 6 : Prevention of abuse

3) The French situation:

- **Definition** of abuse of law ?
 - Created by FTA Doctrine and implemented in Article L 64 of the French Tax Procedure Code
 - The Janfin Case 2006 (general concept of fraud to the law): the *Conseil d'Etat*'s position has been legalized in 2008.
 - Two criteria :
 - 1) pure tax motivation
 - 2) seeking the benefit of a literal interpretation of texts or decisions

Action 6 : Prevention of abuse

3) The French situation:

- Application of abuse of law in an international context → the **Royal Bank of Scotland case** (2006 / 2009) :
 - Application of the French abuse of law concept to alleged abuses of tax treaty;
 - The *Conseil d'Etat* held that the arrangement entered into for the **sole purpose of obtaining treaty benefits** (by a literal interpretation of the texts)

Action 6 : Prevention of abuse

3) The French initiative :

- **New concept** of abuse of law ?
 - 2014: the French Parliament adopted a proposal that enlarges the scope of the abuse of law concept by replacing the « pure tax motivation » test by a « principal tax motivation » test
 - Invalidated by the Constitutional Court (DC n° 2013-685) : the new test would have provided to the FTA a significant margin of discretion in the application of the AoL procedure...
- Articulation of French abuse of law with new international initiative ?

Conclusion

- Examples of interaction between BEPS and EU law
- Implementing BEPS in an EU country is not so simple, even when the country is very BEPS friendly...
- New challenges ahead: multilateral instrument, developing new EU concepts (CCCTB,...)

Thank you for your attention
ありがとうございます

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