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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the implementation of 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 as amended by Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

1. Introduction

Council Directive (EU) 2016/1164[1] of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, as amended by Council Directive (EU) 2017/952[2] of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (further referred to as "the ATAD"), sets out EU measures to address the most common forms of aggressive tax planning by laying down minimum standard rules that should be included in all Member States' corporate income tax laws.

The ATAD ensures a minimum level of protection for all Member States' tax bases, a coherent and consistent approach against tax avoidance throughout the single market, and a coordinated EU implementation of some of the recommendations from the Organisation for Economic Cooperation and Development (OECD)/G20 initiative against base erosion and profit shifting (BEPS) Project. The ATAD provides for measures in five distinct areas, which Members States are required to implement: interest limitation rule, exit taxation, controlled foreign company rule ("CFC"), hybrid mismatches rule and general anti-abuse rule ("GAAR").

1.1. The transposition timeframes

The main[3] ATAD transposition timeline requirements are:

Measure	Transposition deadline	Application date
Interest limitation, GAAR, and CFC	31 December 2018	1 January 2019
Exit taxation, Hybrid mismatches (apart from reverse hybrid mismatches)	31 December 2019	1 January 2020
Reverse hybrid mismatches (with third countries)	31 December 2021	1 January 2022

1.2. The report

Article 10 of the ATAD requires that the Commission evaluate the implementation of the ATAD, in particular the interest limitation provisions, by 9 August 2020, and report to the Council on it. By derogation, the provisions in respect of the hybrid mismatches are required to be evaluated by the Commission by 1 January 2022.

This report is the first step in the evaluation of the impact of the ATAD and provides an overview of the implementation of the early applicable ATAD measures (interest limitation, GAAR, CFC) across Member States[4]. The next step will consist of the delivery of a

[1] OJ L 193 of 19 July 2016, p.1
[2] OJ L 144 of 7 June 2017, p.1
[3] Article 11(6) of the ATAD provides derogation in respect of interest limitation (further details in section 2.1) for certain Member States; Article 11(4) provides for certain derogation for Estonia in respect of exit taxation
[4] As the UK is not part of the EU at this point of time the UK's implementation of the ATAD is not included in this report. The UK was part of the EU at the time the ATAD were adopted and until the end of the transition period of their departure the ATAD are still applicable in the UK.

comprehensive evaluation report of the ATAD measures, including overview of the implementation of those ATAD measures that were not included in this report.

2. Description of measures including options and some approaches available to Member States

Some degree of prescribed optionality is permitted in the transposition of the ATAD measures. Additionally, as the ATAD is a minimum standard directive it allows Member States to provide more restrictive rules in their national legislation transposing the ATAD than the text of the directive prescribes itself, provided that such measures would comply with the fundamental freedoms of the Internal Market. An overview of more noteworthy instances where Member States have provided for stronger measures in their national legislation is also included in this section.

2.1. Interest limitation rule

The *Interest Limitation rule* (Article 4 of the ATAD) limits the deductibility of taxpayers' exceeding (net) borrowing costs by relation to a 30% ratio of taxpayer's taxable earnings before interest, tax, depreciation and amortisation (EBITDA). In addition to this rule, Member States can provide targeted rules against intra-group debt financing, such as thin capitalisation rules.

Member States may consider the overall position of all group entities in the Member State, including a separate entity taxation system, and may allow the transfer of profits or interest capacity between entities within a group, when applying rules that limit the deductibility of interest.

The ATAD provides that, by way of derogation from Article 4, Member States which have national targeted rules for preventing base erosion and profit shifting risks at 8 August 2016, which are equally effective to the interest limitation rule set out in Article 4, may apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard with regard to BEPS Action 4, but at the latest until 1 January 2024. [5]

a) Level of deductibility of exceeding borrowing costs in relation to EBITDA.

Member States may reduce the limit to below 30% ratio if they wish to.

b) Application of de minimis or safe harbour threshold i.e. full deductibility of exceeding borrowing costs up to a threshold

In order to reduce the administrative and compliance burden of the rules without significantly diminishing their effectiveness, Article 4 provides that Member States are free to allow a safe harbour. This safe harbour can be up to a fixed amount of EUR3 million of exceeding borrowing costs as deductible, irrespective of the deductibility limit based on the EBITDA

[5] Further information in section 4.3

ratio. Member States can reduce the fixed threshold in order to ensure a higher level of protection of their domestic tax base.

c) Level of deductibility for standalone entities

Since base erosion and profit shifting in principle takes place through excessive interest payments mostly between associated entities, Article 4 allows Member States to provide for an exclusion of standalone entities from the scope of the interest limitation rule given the limited risks of tax avoidance (i.e. entities that are not subject to transfer pricing rules).

d) Borrowing costs incurred on loans, which were concluded before 17 June 2016

In order to facilitate the transition to the ATAD's interest limitation rule, Article 4 allows Member States to provide for a grandfathering clause that would cover pre-existing loans to the extent that their terms are not subsequently modified. In the case of a subsequent modification, the grandfathering would not apply to any increase in the amount or duration of the loan but would be limited to the original terms of the loan.

e) Borrowing costs incurred on loans used to finance long-term public infrastructure projects in the European Union

Considering that financing arrangements of long-term public infrastructure projects present little or no base erosion and profit shifting risks Member States can exclude exceeding borrowing costs incurred on loans used to fund such projects from the scope of the Article 4 interest limitation rules. In order to avail of this option, the project's operator, borrowing costs, assets and income are all required to be located in the Union.

f) Increased deductibility for a taxpayer, being a member of consolidated group for financial accounting purposes through either:
f.1. The "equity escape" rule under article 4(5)(a) of the ATAD, or
f.2. The "group ratio" rule under article 4(5)(b) of the ATAD.

Where the taxpayer is part of a consolidated accounting group, the group's indebtedness at worldwide level may be considered for the purpose of allowing higher amounts of deductibility of exceeding borrowing costs. To that extent, Member States can provide that a taxpayer is given the right to utilise one of two approaches.

In the first approach, Member States can lay down rules for an equity escape provision, where the interest limitation rule does not apply if the taxpayer can demonstrate that its equity over total assets ratio is broadly equal to or higher than the equivalent ratio of the group.

In the second approach Member States can allow taxpayers to deduct higher amounts of exceeding borrowing costs based on the indebtedness of the overall group at worldwide level vis-à-vis third parties.

g) Member States can provide for rules either:

g.1. to carry forward, without time limitation, exceeding borrowing costs which cannot be deducted in the current tax period;

g.2. to carry forward, without time limitation, and back, for a maximum of three years, exceeding borrowing costs which cannot be deducted in the current tax period, or

g.3. to carry forward, without time limitation, exceeding borrowing costs and, for a maximum of five years, unused interest capacity, which cannot be deducted in the current tax period.

In order to address volatility in taxpayer's profitability, Member States can allow that the amount of unrelieved borrowing costs or interest capacity can be carried forward or back. Member States are free to place a time limit on such carry forward or back to ensure a higher level of protection.

h) Position in respect of financial undertakings

Although it is generally accepted that financial undertakings, i.e. financial institutions and insurance undertakings, should also be subject to limitations to the deductibility of interest, it is equally acknowledged that these two sectors present special features which call for a more customised approach. As the discussions in this field were not sufficiently conclusive in the international and the European Union context, it was not possible to provide specific rules in the financial and insurance sectors. As such, Member States are allowed to exclude certain financial undertakings regulated at EU level from the scope of Article 4.

2.2. The CFC rule

The *Controlled foreign company rule* (Articles 7 and 8 of the ATAD) attributes the income of a low-taxed controlled subsidiary or a permanent establishment ("PE") to its parent company or head office. The parent company or head office becomes taxable on this attributed income in the State where it is resident if the actual corporate tax paid by the controlled entity/PE on its income is lower than the difference between the corporate tax that would have been paid on the same profits in the Member State of the domestic taxpayer/parent company and the actual corporate tax paid by the entity/PE in the source state.

a) Taxation of specific categories of income (article 7(2)(a)) or targeting income artificially diverted to the subsidiary/PE (article 7(2)(b))

Member States can choose CFC rules that either target specific categories of income, or are limited to income which has artificially been diverted to the subsidiary/PE.

"Option A" of the CFC rules provides that certain predefined categories of undistributed passive income (e.g. dividends, interest, royalties and income from financial activities) of the CFC are attributed to the taxpayer (parent company/head office). Income to be included under "option A" is calculated in accordance with the rules of the Member State in which the taxpayer is resident and according to its participation in the CFC.

"Option B" provides that undistributed income of the CFC from non-genuine arrangements that have been put into place for the essential purpose of obtaining a tax advantage is

attributed to the taxpayer (parent company/head office). The attribution of CFC income is to be calculated in accordance with the arm's length principle.

b) *In implementing "option A", Member States are allowed to extended the substance escape provision to CFCs resident or situated in a third country that is not party to the EEA Agreement*

To comply with the EU fundamental freedoms the Article provides a substance carve-out aimed to limit, within the Union (and EEA), the impact of the rules to cases where the CFC does not carry on a substantive economic activity. Member States can extend this carve-out to third countries.

c) *In implementing "option A", Member States are allowed not to treat an entity/PE as a CFC if one-third or less of its income falls within predefined income categories*

With a view to limiting the administrative burden and compliance costs, Member States may exempt certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance.

d) *In implementing "option A", Member States are allowed not to treat financial undertakings as a CFC, where one-third or less of the predefined categories income comes from transactions with the taxpayer or its associated enterprises*

With a view to limiting the administrative burden and compliance costs, Member States are allowed not to treat as a CFC, certain financial undertakings regulated at EU level, for which one-third or less of the predefined categories of income comes from transactions with the taxpayer or its associated enterprises. This is because such undertakings give rise to lower risks of tax avoidance.

e) *In implementing "option B" Member States are allowed to exclude from the scope of the rules an entity or permanent establishment:*
   - *e.1. with accounting profits of no more than €750 thousands, and non-trading income of no more than €75 thousands; or*
   - *e.2. of which the accounting profits amount to no more than 10% of its operating costs for the tax period*

With a view to limiting the administrative burden and compliance costs, Member States may exempt certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance.

f) *Broader definition of a CFC*

Member States are free to follow a broader approach than in Article 7 when defining a CFC, such as reducing the control threshold, or employing a higher threshold in comparing the actual corporate tax paid with the corporate tax that would have been charged in the Member State of the taxpayer.

g) Use of white, grey or black lists

In transposing CFC rules into their national law, Member States can use white, grey or black lists of third countries, which are compiled on the basis of certain criteria set out in the ATAD and may include the corporate tax rate level, or use white lists of Member States compiled on that basis.

2.3. General anti-abuse rule

The *General anti-abuse rule* (Article 6 of the ATAD) tackles abusive tax practices that have not been dealt with through specifically targeted provisions and does not affect the applicability of specific anti-abuse rules. The ATAD requires GAARs to be applied to arrangements that are not genuine, as the taxpayer has the right to choose the most tax efficient structure for its commercial affairs. When evaluating whether an arrangement is to be regarded as genuine, Member States can consider all valid economic reasons, including financial activities.

2.4. Exit taxation

Exit taxation (Article 5 of the ATAD) ensures that where a taxpayer moves assets or its tax residence out of a Member State, that State taxes the economic value of any capital gain created in its territory even though that gain has not yet been realised at the time of the exit. The gain is computed on the market value of the transferred assets at the time of exit of the assets (based on the arm's length principle).

Within the European Union, it is necessary to address the application of exit taxation and illustrate the conditions for being compliant with European Union law. In those situations, taxpayers have the right to either immediately pay the amount of exit tax assessed, or defer payment of the amount of tax by paying it in instalments over a certain number of years. Member States can charge interest on deferred tax, and can require taxpayers to provide a guarantee as a condition for deferring the payment of exit tax where there is a demonstrable and actual risk of non-recovery.

2.5. Hybrid mismatches rule

Hybrid mismatches rule (Articles 9, 9a and 9b of the ATAD introduced by the amending directive) neutralizes the tax effects of hybrid arrangements. Hybrid mismatches are differences between tax systems that can be exploited to achieve: (i) double non-taxation; (ii) double deduction; (iii) deduction without inclusion and (iv) non-taxation without inclusion. These mismatches can subsequently result in base erosion.

The ATAD provides rules to counteract hybrid mismatches arising between EU Member States and with third countries, including imported mismatches, reverse hybrid mismatches and tax residency mismatches.

The ATAD allows some optionality in the scope of the denial of deduction in the payer jurisdiction in certain circumstances and in the exclusion from the scope of certain hybrid

mismatches resulting from a payment of interest under a financial instrument to an associated enterprise until 31 December 2022.

3. Overview of the implementation

This section provides an overview of how Member States have implemented different measures of the ATAD on the basis of the carve-outs, options and different approaches. The format and referencing in this section follows section 2.[6]

3.1. Interest limitation rule

Reference		
2.1.a	30% of the EBITDA	Lower than 30% of the EBITDA
	22	1
2.1.b	€3 million	Less than €3m
	16	6
2.1.c	Standalone entity exemption	No standalone entity exemption
	9	18
2.1.d	Loans before 17 June 2016 excluded	Loans before 17 June 2016 not excluded
	9	18
2.1.e	Public infrastructure loans excluded	Public infrastructure loans not excluded
	16	11
2.1.f	Equity escape available	Group ratio rule available
	8	6
2.1.g	Option g.1 with or without time limitation	Option g.3
	20	1
2.1.h	Financial undertakings excluded	Financial undertakings not excluded
	17	10

[6] Numbers of Member States electing various options indicated in the table do not necessarily add up to 27 as some of the Member States have not yet transposed all ATAD measures. Furthermore, the assessment of national implementing measures by the Commission is still ongoing.

3.2. The CFC rule

Reference				
2.2.a	"Option A" implemented		"Option B" implemented	
	16		10	
2.2.b	The substance escape provision extended to 3rd countries		The substance escape provision not extended to 3rd countries	
	10		5	
2.2.c	one-third or less of income escape clause implemented		one-third or less of income escape clause not implemented	
	12		3	
2.2.d	one-third or less of income escape for financial undertakings implemented		one-third or less of income escape for financial undertakings not implemented	
	5		10	
2.2.e	Low accounting profit or profit margin escape clause provided for		Low accounting profit and profit margin escape clause not provided for	
	7		3	
2.2.f	Broader definition of a CFC		No broader definition of a CFC	
	17		10	
2.2.g	White list	Black list	White and black list	No white, grey or black list
	1	7	1	18

3.3. GAAR

There are no options available to Member States or specific approaches taken by Member States in the transposition of GAAR that require inclusion in this section.

3.4. Exit taxation

As mentioned in section 1.2, the overview of the implementation of exit taxation across Member States will be included in the ATAD evaluation report.

3.5. Hybrid mismatches rule

As mentioned in section 1.2, the overview of the implementation of the hybrid mismatches rule across Member States will be included in the ATAD evaluation report.

4. Completeness and conformity of Member States' transposition of the ATAD

4.1. Actions foreseen by the Commission to ensure timely and adequate implementation of the ATAD by the Member States

As announced in the 2016 "Communication from the Commission — EU law: Better results through better application",[7] the Commission takes various actions to ensure proper application of EU law by the Member States. These actions include (i) dialogue with and assistance to the Member States in their capacity building as well as (ii) conducting formal infringement procedures for violation of EU law. Both types of actions were taken by the Commission to ensure proper implementation and application of ATAD 1 by the Member

[7] OJ C 18 of 19 January 2017, p.10.

States. The Commission has the duty to examine the notifications in **two steps**: (i) **the completeness** of notifications and (ii) **conformity** of notified measures with the Directives.

4.2. "Capacity building" actions taken prior to the deadline for implementation of the ATAD

In 2018, the Commission organized a seminar with the Member States' delegates to discuss the legal issues which arose during the drafting of the implementing legislation. It covered discussion of questions submitted in advance by the Member States with Commission's staff experts.

4.3. Transposition checks and infringement procedures for failure to notify national implementing measures or improper transposition of ATAD

Member States must notify national implementing measures within the deadlines set out in the Directive (31 December 2018 for notification of 3 measures: Interest limitation, GAAR and CFC).

In case of failure to notify the implementing legislation, the Commission opens *ex officio* infringement procedures for failure to communicate the necessary measures (soon after the deadline for notifications set in the respective Directives). Twelve such cases were opened (ten in January 2019[8] and two further in July 2019[9]).

Currently four Member States have not yet fully complied with their obligations to adopt and notify transposition measures.[10] Eight infringement procedures were closed due to Member States compliance.[11]

Furthermore, the Commission opened infringement cases against the Member States that failed to notify national implementing measures for exit taxation[12] and hybrid mismatches,[13] which should have been transposed by 31 December 2019.

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[8] Letters of formal notice were addressed to: Belgium, Cyprus, Czech Republic, Denmark, Greece, Spain, France, Latvia, Portugal and the UK, followed by a reasoned opinion to Denmark in July 2019 (see European Commission press release INF/19/4251 of 25 July 2019, point 13 https://ec.europa.eu/commission/presscorner/detail/en/inf_19_4251).

[9] Letters of formal notice were addressed to Austria and Ireland. Both procedures concern non-communication of national implementing measures for Art. 4 ATAD (interest limitation measure), followed by reasoned opinions in November 2019 (see European Commission press release INF/19/6304 of 27 November 2019, point 8 https://ec.europa.eu/commission/presscorner/detail/en/inf_19_6304). Both States failed to notify such measures, although their pre-ATAD interest limitation provisions were not regarded as "equally effective" by the Commission, see Commission Notice "Measures considered equally effective to Article 4 of the Anti-Tax Avoidance Directive", OJ C 441 of 7 December 2018, p. 1.

[10] Austria, Denmark, Spain and Ireland.

[11] The cases against Belgium, Cyprus, Czechia, France, Greece, Portugal and the United Kingdom were closed in July 2019 (see European Commission press release INF/19/4251 of 25 July 2019, point 13 https://ec.europa.eu/commission/presscorner/detail/en/inf_19_4251) and the case against Latvia was closed in October 2019 (no press release accompanied the decision).

[12] Letters of formal notice were addressed to: Germany, Greece, Latvia, Portugal, Romania and Spain.

[13] Letters of formal notice were addressed to: Cyprus, Germany, Greece, Latvia, Poland, Romania and Spain.

4.4. Current state of play regarding the transposition checks

ATAD Transposition checks table - State of Play - August 2020[14]:

ATAD:	**Interest limitation, GAAR, and CFC**		**Exit taxation**		**Hybrid mismatches** (1st deadline)	
Member state	*Completeness checks*	*Conformity checks*	*Completeness checks*	*Conformity checks*	*Completeness checks*	*Conformity checks*
Belgium	OK	INFR				
Bulgaria	OK					
Czech Republic	OK					
Denmark	INFR					
Germany			INFR		INFR	
Estonia	OK					
Ireland	INFR					
Greece	OK	OK	INFR		INFR	
Spain	INFR		INFR		INFR	
France	OK	OK				
Croatia						
Italy	OK					
Cyprus	OK				INFR	
Latvia	OK	OK	INFR		INFR	
Lithuania	OK	OK				
Luxembourg	OK	INFR				
Hungary						
Malta	OK	OK				
Netherlands						
Austria	INFR		OK	OK		
Poland	OK	OK			INFR	
Portugal	OK	INFR	INFR			
Romania	OK		INFR		OK	OK
Slovenia	OK	OK				
Slovakia	OK	OK				
Finland	OK	OK	OK	OK		
Sweden	OK	OK	OK	OK		

5. Future work

While this report is the first step in the evaluation of the impact of the ATAD and provides an overview of the implementation of the early applicable ATAD measures across Member States, it is envisaged that a comprehensive evaluation report of the ATAD measures will be published, preferably by 1 January 2022. However, the timing of the completion of such comprehensive evaluation report will be dependent to some extent on the need to revise the ATAD due to EU or other international developments in the discussions on preventing corporate tax avoidance practices.

[14] Explanation of the abbreviations used in the table: "OK" - completeness/conformity checks completed; "INFR" - infringement procedure is ongoing; "empty cell" – signifies ongoing assessment.