# NewsAlert

Real Estate Tax Services

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# *EU Anti-Tax Avoidance Package: impacts on the real estate industry*

On 28 January 2016, the EU Commission (EC) presented its EU "Anti-Tax Avoidance Package (ATAP)". The below provides a summary of the package and observations from a real estate (RE) industry perspective.

***The ATAP consists of 7 parts:***

1. A proposed Anti-Tax Avoidance Directive ("draft ATA Directive");
2. An EC Recommendation on the implementation of G20/OECD BEPS recommendations on tax treaty abuse and on permanent establishments (PEs);
3. A proposed amendment to Directive 2011/16/EU on mandatory automatic exchange of information (AEOI) in the field of taxation to enable coordinated implementation of G20/OECD BEPS country-by-country reporting (CBCR) requirements;
4. A general policy Communication on the ATAP and proposed way forward;
5. A general policy Communication on an EU external strategy for effective taxation;
6. An EC Staff Working Document; and
7. A Study on Aggressive Tax Planning.

Although many of the proposals only provide conceptual wording and very little practical guidance, it is clear that these proposals will have an impact on the real estate industry and are thus relevant to monitor and where appropriate to engage in discussions with the relevant institutions to clarify their workings and mitigate potential negative effects for the real estate industry.

Many of the rules reflect the proposals arising from the OECD's BEPS deliverables, however there are some areas where the rules in the draft ATA Directive differ from the corresponding BEPS proposals. The draft ATA Directive also includes rules on additional areas, such as exit taxation and a minimum level of taxation of third country income, which were not included in the OECD BEPS project. The draft ATA Directive stipulates minimum standards to be enacted; it does not prohibit other anti-avoidance rules designed to give greater protection to the corporate tax base.

***Key provisions in draft ATA Directive***

**Deductibility of interest:** A rule restricting net borrowing costs to the higher of EUR 1m or 30% of the taxpayer's EBITDA. There is also suggested wording for a group carve out, which differs from the potential group ratio rule suggested in OECD Action 4. There is a (temporary) exclusion for financial undertakings.

## *Observation for the RE industry*

*While these rules will apply on the aggregate net interest position including both internal and external financing the German model rules have appeared to create a variety of issues. Such a rule would be new for many member States. The EUR 1m threshold is quite obviously very low and will exclude the interest deduction* *limitation in some cases but in many others it will further restrict the interest deduction for tax purposes. Existing models will need to be reviewed to assess the impact of such rule and the need to refinance or restructure to stay within the EUR 1m threshold. Efforts should be made to increase the threshold amounts to for example at least EUR 3m like in the German model provision. For the avoidance of doubt the law should also provide an exemption for REITs and not only for AIFs as has been suggested. It is unclear whether entities controlled by AIF's are also exempt from the rule.*

Rules for **exit taxation** where a taxpayer transfers assets (between a head office and its PE, or between PEs) out of a Member State to another Member State or to a third country, or transfers its tax residence to another Member State or to a third country, or transfers its PE out of a Member State.

## Observation for the RE industry

*Given the nature of the Real Estate business and the fact that the assets are by definition immovable, the impact of such rule as one would expect should be limited. Nonetheless, there could be an impact if certain departments or functions within a business are relocated to another jurisdiction. In the latter case the taxpayer will be deemed to have realised the fair market value of the department/function and be assessed on the gain, if any. Transfers within the EU will be granted a deferral and payment over a period of at least 5 years. This appears not to be justified at all and an exemption should be provided for that no exit tax is due where the taxation right of income from immovable property does not change.*

A **"switch-over" clause** to ensure taxation of dividends and capital gains in respect of companies in a low tax third country. This clause also applies to low taxed PE profits from third countries. The test for 'low tax' has been set at 40% of the statutory tax rate in the Member State of the taxpayer (i.e. the company disposing of the shares/ receiving the distribution/holding the branch).

## Observation for the RE industry

*This rule only applies to income coming from outside the EU. Member States will need to apply a credit rather than an exemption on income and capital gains if such income does not meet the minimum threshold of taxation. The threshold is set at 40% of the statutory tax rate of the Member State receiving the income/capital gain. The proposal contains very little guidance on how exactly this is to be calculated in case of timing differences and other specific rules applicable in the respective jurisdictions. The current proposal does not provide for an exception for legitimately low taxed entities such as REITs and tax exempt AIFs.*

A **general anti-abuse rule (GAAR)** allowing tax authorities to ignore arrangements where the essential purpose is to obtain a tax advantage that defeats the object or purpose of the tax provision and where the arrangements are not regarded as genuine.

## Observation for the RE industry

*This is to introduce a general anti-abuse rule in the tax systems of the Member States. The wording of the GAAR is wide and currently lacks detailed guidance. If implemented, the level of uncertainty about the tax effects of structures will increase and the interpretation burden will be shifted to the fiscal courts in a dispute. The Real Estate industry will equally be impacted as any other industry.*

**CFC rules** dealing with entities subject to a low level of taxation (40% of the parent's effective rate) where more than 50% of the entity's income falls within specified categories (broadly, passive income). Where the CFC is resident in the EU/EEA, the rules only apply if the entity's establishment is wholly artificial or the entity engages in non-genuine arrangements with the essential purpose of obtaining a tax advantage.

## Observation for the RE industry

*The CFC rules look familiar from the German CFC rules in place for many years. If applicable, the CFC rules accelerate the inclusion of income at the level of the parent company. Focus on passive income includes lease rentals. As such, the proposed CFC rules will potentially impact the Real Estate industry. Existing structures will need to be reviewed and an assessment will need to be made if and how income will be taxed at the level of the parent entity and whether repatriation strategies need to be adjusted to better align the timing of inclusion of income with actual cash flows. As experience shows CFC rules are always a source of numerous technical issues and a risk of effective double taxation remains.*

**Rules addressing mismatches** between Member States arising due to hybrid entities or hybrid instruments, whereby the characterization of the entity or instrument in the Member State where the payment has its source is followed by the other Member State which is involved in the mismatch.

### *Observation for the RE industry*

*This will for many Member States be a fundamental change on dealing with hybrid mismatches. Currently, there is little alignment of national rules in dealing with hybrid mismatches, other than the recently introduced amendments to the EU Parent/Subsidiary Directive.*
*Every structure and financing will need to be reviewed to assess if there is a mismatch in treatment at the level of the source Member State and the level of the recipient Member State. Based on the results of the assessment, both corporate and financing structures may need to be amended to mitigate the impact of this suggested rule.*
*To be adopted, the Directive requires unanimity in ECOFIN of all Member States. We understand that it is still an open question for Member States whether the draft ATA Directive should be negotiated in Council as an integral package or could be dealt with in separate parts, as was done with the EU Parent-Subsidiary Directive, i.e. some provisions could be fast-tracked and become effective quicker than others. Given the political momentum around BEPS and pressure on the EC on this dossier, the EC will aim to have the Directive adopted within the next 6 months so it might come into effect on 1 January or 1 July 2017, although this seems ambitious.*

## *The EC furthermore issued a Recommendation on implementation of measures to tackle tax treaty abuse*

The EC Recommendation urges Member States to implement the OECD BEPS proposals to address tax treaty abuse. Where Member States include in tax treaties a GAAR based on a principal purpose test (PPT) as suggested in the OECD's final report on BEPS Action 6 (Prevention of Treaty Abuse), the EC recommends that the rule should be modified to comply with EU case law such that genuine economic activity is not affected. Member States are also encouraged to amend treaty definitions of permanent establishment to reflect the OECD's proposed amendments to Article 5 of the OECD Model Tax Convention as set out in the OECD's final report on BEPS Action 7 (preventing the artificial avoidance of PE status). Member States are required to inform the EC on the measures taken to comply with the Recommendation, and the EC will publish a report on the application of the Recommendation within 3 years of its adoption.

### *Observation for the RE industry*

*Access to treaty benefits will be stricter. Structures should be reviewed to assess access to the sought benefits and where necessary structures should be amended or made more robust to continue to be eligible to the treaty benefits.*

Thirdly, the EC proposes coordinated implementation within the EU of OECD BEPS Action 13 CBCR requirements by extending the scope of the recently amended EU Directive on mandatory AEOI / tax rulings and advance pricing agreements (APAs) amongst EU tax administrations. We understand that since most of the EU Member States are also OECD members and have already approved and committed to implementing BEPS Action 13, this amendment could be adopted in Council within weeks, that is, if Member States do not raise any new technical issues. The Directive would enter into effect on 1 January 2017. NB: the EC will still issue a proposal and Impact Assessment for CBCR with public disclosure in spring 2016.

### *Observation for the RE industry*

*This is mostly to facilitate a coordinated implementation to allow the information sharing between tax authorities as agreed in the BEPS reports. However, a proposal for a public CBCR exceeds the agreement reached in the BEPS reports.*

Fourthly, in the general policy Communication the EC explains the rationale behind the ATAP. The EC notes that the majority of businesses do not engage in aggressive tax planning and suffer a competitive disadvantage to those that do, in particular SMEs. The EC adds that Member States suffer significant revenue loss from this. The EC hails the BEPS project but states the EU can and should go further to ensure that Member States develop a ‘common standard’ and level-playing field by implementing the ATAP in a coordinated manner, and with CCCTB clearly as the preferred holistic solution to profit shifting, transparency and effective corporate taxation in the EU. The EC claims to be on track to adopt the new CCCTB legislative proposal in autumn 2016. To placate business concerns, the EC states that the measures included in the ATAP have been designed so as to minimise the risk of double taxation and disputes 'as much as possible'. The EC recalls that its work on an impact assessment on dispute resolution is progressing, with a view to presenting a new proposal in the summer.

### Observation for the RE industry

*The general policy Communication is purely to provide a background to the proposals and to put them into context. As such, it has no immediate impact on the RE industry. The introduction of a CCCTB could be a game changer overall, although the RE industry is likely to be least affected given the strong link to the situs of the assets. Nonetheless, a tax system on an EU-wide consolidated basis will have a major impact and it may be used to justify harmonisation also in regards of tax exempt vehicles like funds and REITs which may reasonably demand a EU-model taxation cross border.*

Fifthly, the Communication on an EU external strategy for effective taxation sets out the EC's ideas for promoting tax good governance with non-EU countries, e.g. through a special clause in trade agreements, and assistance to developing countries on tax matters. Most importantly, the EC wants a common EU system for assessing, screening and listing third countries. The Communication does not, however, address the counteraction to be taken against listed countries. An update of the EC's controversial June 2015 list of non-EU country non-cooperative tax jurisdictions is published online in an interactive map.

### Observation for the RE industry

*Although currently unclear what the consequences will be of a listing of a jurisdiction, the likely impact will be to steer away from using entities in listed jurisdictions.*

Sixthly, the EC published a new study on aggressive tax planning (ATP) which it commissioned in order to identify indicators which facilitate ATP, and then reviews the corporate income tax systems of Member States against the ATP indicators, in order to identify tax rules and practices that result in Member States being vulnerable to ATP. Written by independent advisors and national tax experts, the study does not necessarily reflect the official opinion of the EC.

The study draws out the following general observations:

- results imply that scope exists for Member States to tighten their anti-abuse rules in order to counter base erosion by means of financing costs;
- nearly half (13) of Member States did not apply any beneficial owner test when accepting a claim for a reduction or exemption of withholding tax;
- half of Member States do not have CFC rules; and
- very few Member State have rules to counter the mismatching tax qualification of a local partnership or company by another state (typically the state of the owners); and
- although most (26) Member States have general or specific anti-avoidance rules, the study notes that it appears that the rules in place can be only partially efficient to prevent ATP structures.

### Observation for the RE industry

*The study does not comment on any RE specific items and in substance there seems to be no new findings.*

Lastly, an **EC Staff Working Document accompanies the ATAP and is used to underpin the EC's economic and academic analysis** on the drivers and most common mechanisms which are linked to aggressive tax planning. The annex to this EC document also includes an overview of the 15 OECD BEPS Actions and corresponding EU actions.

### Observation for the RE industry

*The Staff Working Document does not comment on any RE specific items.*

### Our view

*The very many items addressed in the summary before indicate that the real estate industry needs to be very cautious and alert to changes directly initiated on the basis of the planned Directive or from single country-by-country efforts ahead or in parallel of such Directive. Lobbying for protecting the real estate industry's interests will be very important and needs to be put in place rapidly.*

# For more information, please contact your local PwC real estate tax service provider or one of the contacts below.


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