Aalto-yliopisto
Kauppakorkeakoulu

# 32E29000 European and international tax law

## EU Tax Law: Corporate Tax Directives

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# What is a directive?

- Directives are a means of positive integration in the EU
- The aim is to harmonize tax laws of the EU member states to extent this is necessary for the functioning of the internal market
- Adoption of directives in the field of direct taxation require unanimity (each country must agree) by the member states
- EU Commission (proposes), EU Parliament (comments) & EU Council (accepts), right interpretation (EU Court of Justice)

# What is a directive?

- “A directive shall be binding, as to the result to be achieved, upon each member state to which it is addressed, but shall leave to the national authorities the choice of form and methods”
- Directives must be implemented by the EU member states into <u>their national tax laws</u> → national tax law must be amended to comply with the requirements of a directive

# EU corporate tax directives

- For multinational corporations (MNCs) the following directives are of great importance
  - Parent-Subsidiary Directive
  - Interest-Royalty Directive
  - Merger Directive (not discussed further during the course)
  - As of 2019: Anti Tax Avoidance Directive (ATAD)

# Parent-Subsidiary Directive - Scope

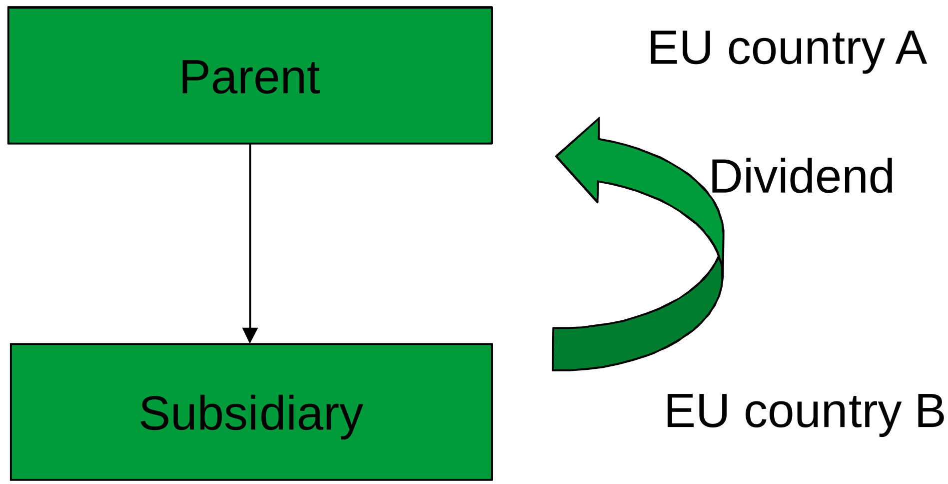
- “**Profit distributions**” → typically dividend
- Between “qualifying subsidiary and parent companies resident in EU member states”
  - “**Qualifying Company**” (Art 2 of the Directive):
    - 1) company form listed in the Annex: limited liability companies (Finland: oy, osuuskunta..)
    - 2) resident for tax purposes in an EU Member State
    - 3) liability to corporation tax
  - **Ownership threshold** ≥ 10%
  - Option to require a minimum holding period of 2 years → Finland: no minimum holding period required

# Parent-Subsidiary Directive – Tax treatment

- Eliminates <u>both</u> juridical and economical double taxation
- Source state: exemption from withholding tax
- Residence state: exemption from corporation tax or credit for tax paid by the subsidiary on the profits → Finland: exemption method

# Parent-Subsidiary Directive – Tax treatment

**No corporate tax on dividends**




**Corporate tax on profits**
**No withholding tax on dividends**

# Parent-Subsidiary Directive - Implementation in Finland

- Sec. 3(6) of the Act on Taxation of Income of a Person Subject to Limited Tax Liability (*Laki rajoitetusti verovelvollisen tulon verottamisesta)*
  - No withholding tax on dividend if paid to a company within the meaning of Art 2. of the Parent-Subsidiary Directive provided that the recipient holds directly at least 10 % of the capital in the distributing company
- Sec. 6a of the Business Income Tax Act (*elinkeinoverolaki*)
  - Dividend received by a corporation is not taxable if received either from a domestic corporation or from a foreign company within the meaning of Art. 2 of the EU Parent-Subsidiary Directive

# Anti tax-avoidance rule in Parent-Subsidiary Directive

- The residence state must tax (ie. exemption/credit is not permitted) dividends to the extent such dividends are deductible by the subsidiary (hybrid situation) or if the dividend relates to a tax avoidance arrangement
- Eliminates double non-taxation of dividends

# Interest-Royalty Directive - Scope

- Eliminates juridical double taxation of interest and royalties by exempting the payment in the source state
- Applies to **interest** and **royalty** income paid between "**associated companies** resident in EU member states"
- Associated company
  - 1) company form listed in the Annex: limited liability companies (Finland: oy, osuuskunta..)
  - 2) resident for tax purposes in an EU Member State
  - 3) liability to corporation tax
  - Ownership threshold $\geq$ 25 %
  - Option to require a minimum holding period of 2 years → Finland: no minimum holding period required

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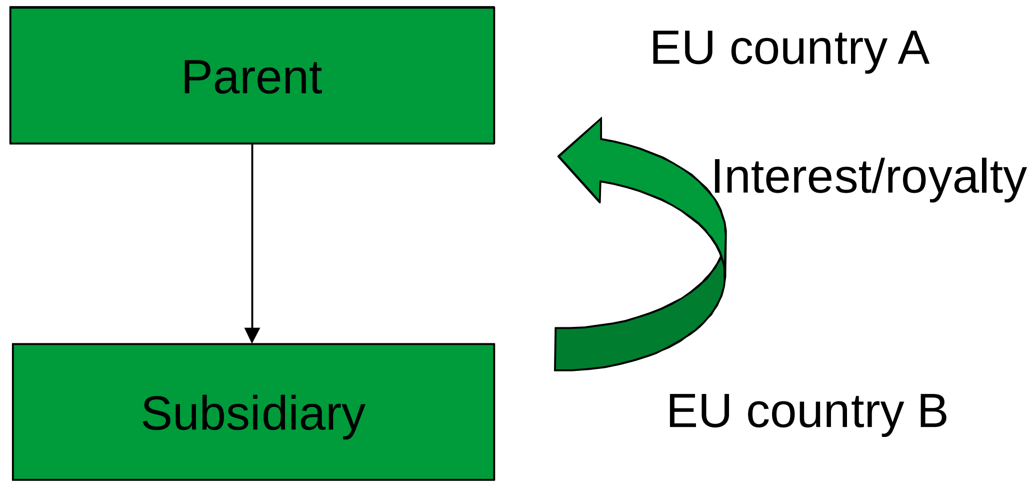
# Interest-Royalty Directive – Tax treatment

**Corporate tax on interest/royalty**




**No withholding tax on interest/royalty**
**Note: Interest/royalty deductible in corporate taxation (unless specific limitation apply)**

# Interest-Royalty Directive – Implementation in Finland

- Interest
  - Finland exempts interest paid to non-residents from withholding tax under Sec 9(2) of the Income Tax Act
  - Interest-Royalty Directive has in practice no relevance in Finland = Finnish domestic tax law in line with the requirements of the Directive
- Royalty
  - Sec. 3(b) of the Act on Taxation of Income of a Person Subject to Limited Tax Liability: no withholding tax if the situation falls within the Interest-Royalty Directive

# EU Anti-Tax Avoidance Directive (ATAD)

- Aim is to counteract some of the most common types of aggressive tax planning → protect tax bases of member states
- Must be implemented as from 1.1.2019 (unless some exceptions apply)
- **Minimum protection principle** → member states must implement at least as strict anti-tax avoidance rules as laid down in the directive but may apply even stricter rules
- Includes 5 measures

# EU Anti-Tax Avoidance Directive (ATAD)

- Includes 5 measures
  - **Controlled foreign company (CFC) rule**: to deter profit shifting to a low/no tax country.
  - **Interest limitation:** to discourage debt arrangements designed to minimise taxes
  - **Exit taxation:** to prevent companies from avoiding tax when re-locating assets.
  - **Hybrid mismatch rules:** to avoid mismatches resulting in double non-taxation
  - **General anti-abuse rule:** to counteract aggressive tax planning when other more specific anti-avoidance rules don’t apply

# Finnish CFC rules as of 2019

- Undistributed profits of a foreign corporation may be taxed as profit of the Finnish resident direct or indirect shareholders if the foreign corporation qualifies as a controlled foreign company (CFC)
- Normally the profits of a foreign corporation is taxed only when the corporation distributes dividends to a Finnish resident shareholder or the shareholders sells the shares of the foreign corporation

# Finnish CFC rules as of 2019

- Definition of CFC
  – **Control:** ≥ 25% ownership (of voting rights or capital) by a Finnish corporation (or individual) alone or together with related parties
  – **Low taxation** = the actual income tax burden of the foreign corporations in its country of residence is <u>lower than 3/5</u> of the tax burden of a comparable Finnish entity (i.e. < 12,5 %)
- Substantive economic activity exception
  – Based on the case law of the EU Court of Justice
  – Applied when a taxpayer can establish that a CFC carries on substantive economic activity in its residence country. This needs to be sufficiently supported by staff, equipment, assets and premises.

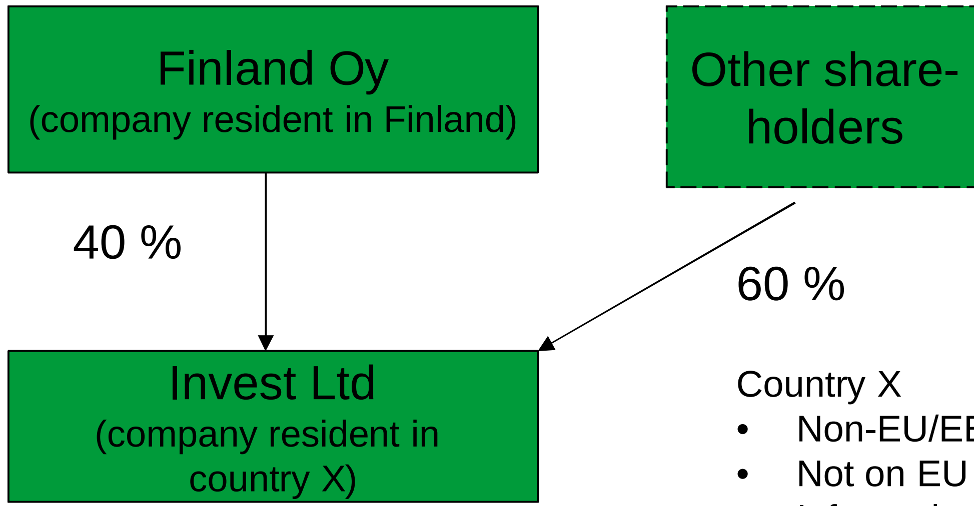
# Finnish CFC rules as of 2019

- Applicable when a CFC is established in EU or EEA (European Economic Area, i.e. Iceland, Liechtenstein and Norway)
- Applicable also when a CFC is established in a non-EU or –EEA country but the following conditions must also be satisfied
  - The country of residence is not mentioned in the EU list of non-co-operative countries (EU black list)
  - There is an effective agreement on sufficient information exchange between Finland and the country of residence of a CFC
  - The income of a CFC comprises principally of industrial or other comparable production or service activities, or sale and marketing activities that serve before-mentioned activities

# Finnish CFC rules as of 2019

- The income of a CFC must be calculated according to the Finnish tax rules
- The income (**CFC income**) is included in the taxable income of Finnish shareholder in proportion to the ownership
- To eliminate double taxation of CFC income
  - the taxes paid by the CFC on the income taxed as CFC income are credited in Finland
  - the dividends from a CFC are not taxed if they are distributed within the next 5 years
  - the capital gain on the sale of shares in the CFC is taxable only to the extent the amount of gain exceeds the taxed CFC income

# Example: CFC or not?




- Tax rate on profits 9 %
- Activities consist of trading of shares

Country X
- Non-EU/EEA
- Not on EU black list
- Information exchange agreement with Finland