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Štěpán Knetl

Implementation of ATAD

Master's Thesis

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V Praze dne 6. srpna 2018

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Introduction

When the prime minister of Iceland Sigmundur Davíð Gunnlaugsson woke up on the 3rd of April 2016 he probably did not expect that his career was coming to a quick end. Shortly after being asked about his connection to the company Wintris, allegedly used to hide millions of Icelandic crowns in an offshore account, he was forced to step down as the prime minister of Iceland.¹ He became the first major causality of the Panama Papers - one of the biggest tax scandals in history. The Panama Papers pointed at the use of offshore entities for hiding wealth or avoiding paying taxes by wealthy individuals and public officials.

As reported net budgetary resources lost due to the tax avoidance are reaching hardly imaginable amounts², the search for solutions through cooperation in tax administration appears to be crucial. The necessity of adoption of new measures emerges in relation to both the internal European market and third countries as tax avoidance is facilitated by various schemes. This has been acknowledged by the OECD's Base erosion and profit shifting programme (BEPS) to tackle tax avoidance already in 2013. Three years after 15 of BEPS recommended Actions were introduced we can see some concrete results in a form of legislation.

One of the legislative tools supposed to prevent tax avoidance in the European Union is the new Anti-tax avoidance directive. It is introducing the minimal standard of protection against the phenomenon in the EU through implementation of several measures, namely the interest limitation rule, exit taxation, the general anti-abuse rule, controlled foreign company rules and measures tackling so-called hybrid mismatches. The member states, including the Czech Republic, are obliged to transpose the content of ATAD into national legal systems as of 31st December 2018 the latest.

The aim of this thesis is to firstly, present the directive in its historical context and critically evaluate its content and consequently examine proposed implementation into the Czech legal framework and its potential shortcomings. In order to fulfil the goal, I have set up three questions that should be answered:

¹ Iceland PM steps aside after protests over Panama Papers revelations. Theguardian.com [online]. [visited on 2018-03-25]. Available at: <https://www.theguardian.com/world/2016/apr/05/iceland-prime-minister-resigns-over-panama-papers-revelations>

² For instance, in 2015 the IMF estimated worldwide losses of BEPS related to tax havens at approximately 600 billion US dollars. IMF Working Paper. Imf.org [online]. p.21. [visited on 2018-03-15]. Available at: <https://www.imf.org/external/pubs/ft/wp/2015/wp15118.pdf>

- 1) What are the reasons for adoption of ATAD and are there any alternative or complementary regulatory measures?
- 2) What are the main measures introduced in ATAD and do they pose an optimal solution to the presented problem of tax avoidance?
- 3) How will ATAD be implemented into the Czech legal framework and could the suggested form of implementation be criticised?

In the thesis, I will first briefly outline reasons leading the international community to act in this area. In the same chapter, I will describe several key concepts necessary for further understanding of the topic together with the historical development of measures proposed both on OECD and European level.

In the second chapter, I will focus on the main subject of this thesis - the Anti-tax avoidance directive. It is one of the first major tangible results of OECD's Base Erosion and Profit Shifting recommendations from 2013 being implemented into national legal frameworks in the European legal environment. Main goals of ATAD are to ensure that tax is paid where profits and value are generated and restore the undermined public trust in the fairness of tax systems in general.³ I will describe and critically evaluate the directive as well as its key measures individually and consider whether the instruments are appropriate to meet the above-mentioned goals.

In the third part, I will focus on specifics of the implementation of directive into the Czech legal framework. In other words, I will describe and evaluate which options out of the offered alternatives were chosen or which thresholds were deemed to be optimal for the Czech context. I will also outline the way in which the directive will be implemented and how it will affect the Czech legislation.

Throughout the work, I use the method of systematic analysis of the proposed legislation. I will also rely on the method of deduction while trying to evaluate the potential impact of proposed measures and anticipate their impact. The method of description is also being used, mostly to introduce and explain individual measures in the first place.

The transposition period for ATAD will elapse as of 31st December 2018. As this thesis is being finalized in the middle of 2018, the legislative process is still running and the implementation only exists in the form of a proposal, currently in the chamber of deputies.

³ EUROPEAN COMMISSION, "Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market," p. 10

The topic itself is quite novel and therefore, as to the authors knowledge, it is not yet discussed in classic financial law literature or textbooks. There are, however, already numerous articles in scientific journals that I will widely use. Other sources include parts of the legislation itself, various commission documents, research papers, theses, and explanatory statements. Beside the examined legislative proposal, the thesis reflects on the legislation effective as of 31st June 2018.

1. Current Developments in International Cooperation in Tax Administration

1.1 Tax Evasion, Tax Avoidance, Tax Planning and Tax Havens

According to the European Parliamentary research service, the cost of tax avoidance in 2015 alone was estimated between 160 and 190 billion EUR in the EU. For comparison, the entire EU budget in 2016 was approximately 145,3 billion EUR⁴. Being designed more than a hundred years ago, the current system of international taxation does not reflect the globalized economic reality of the 21st century. Revelations of hundreds of millions of EUR floating to the tax havens are not only directly affecting national budgets, but create a strong feeling of estrangement among the public that can hardly avoid paying what is often referred to as ‘fair share’ of the tax burden. This might be in part responsible for the ongoing loss of trust in the modern democratic institutional framework. These indirect costs are likely impossible to quantify, but deserve to be mentioned.

Tax scandals like the Panama papers, Lux Leaks or Swiss Leaks are heavily influencing the public debate on the justice of the corporate tax system. In this context it is important to explain the terms tax evasion, tax avoidance and tax planning, which are sometimes being used interchangeably, yet their meanings are different. According to Merks, **tax evasion**⁵ is an inherently illegal activity punishable by criminal sanctions. It is an action by a taxpayer, which entails breaking the law and which, moreover, can be shown to have been taken with the intention of escaping payment of tax.⁶ On the other hand, OECD defines **tax avoidance**⁷ as the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that, although the arrangement could be strictly legal, is usually in contradiction with the intent of the law it purports to follow.⁸ Sejkora concludes that even though both terms might be partly overlapping, in case of tax avoidance, the taxpayer interprets the tax law in a wrong manner, which may result in unlawful conduct, even though the taxpayer was convinced his arrangements are in compliance with the tax law provisions concerned. It must not have been

⁴ EUROPEAN COMMISSION, Annual budget life-cycle: figures. ec.europa.eu [online]. [visited on 2018-04-03]. Available at: http://ec.europa.eu/budget/annual/index_en.cfm?year=2015

⁵ According to Sejkora, the Czech equivalent used in practice would be ‘daňový únik’, even though he concludes that its meaning is probably even broader.

SEJKORA, Tomáš. *Finančněprávní nástroje boje proti únikům na dani z přidané hodnoty v prostoru Evropské unie*. Prague: Leges 2017. ISBN 978-80-7502-226-4 p. 76

⁶ MERKS, Paulus. Tax Evasion, Tax Avoidance and Tax Planning. Intertax. 2006, Volume 34, Issue 5, p. 272. ISSN 0165-2826

⁷ The Czech translation being ‘vyhýbání se daňové povinnosti’.

⁸ OECD, Glossary of Tax Terms. Oecd.org [online]. [visited on 2018-04-03]. Available at: <http://www.oecd.org/ctp/glossaryoftaxterms.htm>

the taxpayer's intent to violate the tax law. If there were such intentions, the taxpayer's conduct would have been called tax evasion.⁹ Contrary to these, **tax planning** is a perfectly acceptable activity of reducing the tax burden by, for instance, choosing the most advantageous option consistent with normal business transactions among tax reliefs and incentives, or even by refraining from consuming a taxed product. It is clearly not the intention of governments to combat activities of this kind.¹⁰

Practices that exploit gaps and mismatches in tax rules to reduce the tax burden by shifting profit to low or no tax jurisdiction might not be morally justified, yet are not illegal. Such jurisdictions are often referred to as **tax havens**. The OECD provides us with four key factors that should help us identify tax havens. These are i) no or only nominal taxes, ii) lack of effective exchange of information, iii) lack of transparency and iv) no substantial activities.¹¹ In the same report the term **harmful preferential tax regime** is also used, referring to a more specific case of harmful tax competition, defined as countries fulfilling the criterion of i) no or low effective tax rates in conjunction with one or more of the following: ii) 'Ring fencing' of regimes (for instance explicit or implicit exclusion of resident taxpayers from taking advantage of its benefits as they could pose a threat to the domestic market), iii) lack of transparency and iv) lack of effective exchange of information.¹² The main difference between the two is that tax havens are countries that are able to finance their public services with no or nominal income taxes and that offer themselves as places to be used by non-residents to escape tax in their country of residence while countries with harmful preferential tax regimes raise significant revenues from their income tax.¹³ This motivational variance is reflected by recommendation of different policies regarding each of the groups.

It is understandable that due to the differences in tax system architecture among countries we cannot rely only on nominal tax rates found in tax codes. As the aforementioned report suggests, we should rather focus on an effective tax rate, which takes other aspects of tax construction into account as well.¹⁴ Contrary to popular belief we might consequently conclude

SEJKORA, Tomáš. *Finančněprávní nástroje boje proti únikům na dani z přidané hodnoty v prostoru Evropské unie*. Prague: Leges 2017. ISBN 978-80-7502-226-4 p.76

¹⁰ OECD, *International Tax Avoidance and Evasion*, Four related studies. Paris. 1987. p. 11. ISBN 9264129251.

¹¹ OECD, *Harmful Tax Competition: An Emerging Global Issue*. Oecd.org [online]. 1998. [visited on 2018-04-05]. Available at: <https://www.oecd.org/tax/transparency/44430243.pdf>, p. 23

¹² Ibid., p. 27

¹³ Ibid., p. 20

¹⁴ For instance, according to CNBC, Apple had only paid an effective tax rate of 0.005% in Ireland in the year 2014 due to the special agreement with the Irish government and a creative use of tax avoidance practices. This has resulted in the European Commission ruling 13 billion EUR as undue tax benefit forcing Apple to pay the

that countries applying harmful preferential tax regimes are not only dreamlike islands in the Caribbean, but in certain cases also EU member states.^{15,16}

1.2 BEPS

Tax avoidance practices can be summarized as activities resulting in an **erosion of tax base** and **shifting of profits** to jurisdiction enforcing little or no tax liabilities. Both tax avoidance and tax evasion were subject to severe public criticism especially after the financial crisis in 2008 and the economic downfall that followed. The search for someone to blame for the decrease in tax revenue was firstly directed at the financial system that was blamed for causing the crisis itself and later to some extent shifted to multinational enterprises, especially after aforementioned tax scandals. The governments were eager to use this opportunity to increase their tax incomes and arguably quite hypocritically joined the fight against the base erosion and profit shifting. As Kemmeren points out, the differences in tax systems have been made possible by the same countries who are now complaining about BEPS structures. He also argues that they were not really interested in cooperating with each other to align tax systems, as long as they thought that they had more to gain from tax competition than from tax coordination.¹⁷ Nevertheless, studies that confirm negative impact of BEPS on the corporate income tax revenues are coming from numerous researches, including those done by IMF, UNCTAD, OECD or EPRS.¹⁸

In 2013 the OECD introduced an initiative aiming to prevent tax avoidance bearing the same name - Base Erosion and Profit Shifting Package. The goal is to equip governments with domestic and international instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is

largest tax assessment in the history of taxation. CNBC – More information online:

<https://www.cnbc.com/2016/08/30/how-apples-irish-subsiidiaries-paid-a-0005-percent-tax-rate-in-2014.html>

¹⁵ EU member countries that might fulfil the OECD criteria are for instance Cyprus, Ireland, Malta or Luxemburg.

¹⁶ In this context the so-called “race to the bottom” phenomenon is sometimes pointed out referring to the significant decrease in corporate income tax rates in the past several decades. However, if we examine for instance the case of Sweden, even though the tax rate before the tax reform in 1991 was 57%, the effective rate was as low as 20% due to deductions, allowances and special valuation rules etc. Lecture of Bo Stoltz on Law and Economics II. at Stockholm University on 6th March 2018.

¹⁷ KEMMEREN, Eric C.C.M.. Where is EU Law in the OECD BEPS Discussion. EC Tax Review. 2014. Volume 23. Issue 4, p. 190. ISSN: 0928-2750

¹⁸ JÁNSKÝ, Petr. 2016. Estimating the Costs of International Corporate Tax Avoidance: The Case of the Czech Republic. IES FSV, Charles University, 2016., p.3

created. The OECD presented 15 specific actions it recommends to the governments in October 2015. These recommended Actions are the following:

- 1: Addressing the Tax Challenges of the Digital Economy
- 2: Neutralising the Effects of Hybrid Mismatch Arrangements
- 3: Designing Effective Controlled Foreign Company Rules
- 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
- 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
- 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
- 7: Preventing the Artificial Avoidance of Permanent Establishment Status
- 8–10: Aligning Transfer Pricing Outcomes with Value Creation
- 11: Measuring and Monitoring BEPS
- 12: Mandatory Disclosure Rules
- 13: Transfer Pricing Documentation and Country-by-Country Reporting
- 14: Making Dispute Resolution Mechanisms More Effective
- 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties¹⁹

A number of these, such as hybrid mismatches (Action 2), controlled foreign company rules (Action 3), limits on interest deductions (Action 4), are now being implemented through ATAD. The OECD BEPS package can therefore often help when considering the primary source of these measures. The Directive itself refers to BEPS in the recitals of its preamble many times.

The BEPS package is criticised for various reasons. Firstly, critics claim that it was negotiated and prepared by the OECD²⁰, occasionally nicknamed ‘rich man’s club’²¹ and some, therefore, argue that although it was also supported by the G20 group, interests of developing countries are largely underrepresented.²² None of these are considered a suitable platform for

¹⁹ OECD. 2015. Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project. 2015.

²⁰ The main goal of the OECD is to promote policies designed ‘to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy’, Article 1(a) of the Convention on the Organisation for Economic Cooperation and Development, Paris, 14 December 1960

²¹ For instance, by The Economist. What is OECD?. Economist.com [online]. 2017. [visited on 2018-06-06] Available at: <https://www.economist.com/the-economist-explains/2017/07/05/what-is-the-oecd>

²² FUNG, Sissie, "The Questionable Legitimacy of the OECD/G20 BEPS Project", *Erasmus Law Review*, 2, 2017. p. 76-88. DOI: 10.5553/ELR.000085

negotiation of the reform of international taxation as BEPS is sometimes referred to. These concerns seem legitimate, in spite of the fact that the only representative of the African continent in the BEPS-44 group²³ is the South African Republic. Europe, on the other hand, is not only represented by many countries, but by the EU in both forums as well. This is a problem, as resulting from this democratic deficit, developing countries will have to comply with norms they did not have any say in designing. Furthermore, it should be mentioned that for such low-income countries, the administrative costs of implementing the BEPS framework might pose a far bigger share of their resources than for the developed ones.

Other critics claim that ‘the proposals offer a patch-up of existing rules, making them even more complex and in many cases contradictory, and do not provide a coherent and comprehensive set of reforms.’²⁴

1.3 EU’s Anti-Tax Avoidance Package

Following the BEPS initiative, the European Commission has introduced its own action plan²⁵ on efficient taxation in 2015. In January 2016 some parts of the proposal were ‘rebranded’ into an Anti-Tax Avoidance Package. This initiative included (i) ATAD, (ii) recommendation on tax treaties, (iii) Revision of Administrative Cooperation Directive and (iv) Communication on external strategy. The Commission presents these as the key points of its anti-tax avoidance efforts. Regarding this area, I will touch upon the common consolidated corporate tax base proposal as well, which is also to a large extent presented as an anti-tax avoidance measure. It is perhaps worth noting here, that the Commission’s proposals are subject to criticism for going above and beyond the BEPS proposals and thus undermining the BEPS consensus and the G20 agenda to improve tax certainty.²⁶

²³ Representing the OECD’s 34 countries together with leftover G20 members.

²⁴ BEPS MONITORING GROUP, ‘Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project’ [online]. bepsmonitoringgroup.wordpress.com. 2015. [visited on 2018-05-07]. Available at: <https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf> p.1-2

²⁵ Its main goals were

1. Re-launching the Common Consolidated Corporate Tax Base (CCCTB)
2. Ensuring fair taxation where profits are generated
3. Creating a better business environment
4. Increasing transparency
5. Improving EU coordination

EUROPEAN COMMISSION, Anti-tax Avoidance Package. [Ec.europa.eu](https://ec.europa.eu) [online]. 2016. [visited on 2018-05-08]. Available at: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en

²⁶ FUNG, Sissie, "The Questionable Legitimacy of the OECD/G20 BEPS Project", *Erasmus Law Review*, 2, 2017. DOI: 10.5553/ELR.000085, p. 77

In the Recommendation on tax treaties (ii) the Commission notes that tax treaties create opportunities for no or reduced taxation through treaty shopping or other abusive strategies. The aim is to prevent the granting of treaty benefits in inappropriate circumstances (action 6 of BEPS report) and preventing the artificial avoidance of permanent establishment status (action 7 of BEPS report). It covers the introduction of general anti-abuse rules based on a principal purpose test and the revision of the definition of permanent establishment in tax treaties.²⁷ Understandably, due to the form of the recommendation document it does not imply any direct legal obligations.

As a reaction to the Panama Papers the Commission has called for a further increase in tax transparency to tackle tax abuses and close the information gap. As a result, the Council Directive 2011/16/EU concerning administrative cooperation in the field of taxation (referred to as DAC) (iii), was amended again (amendment is referred to as ‘DAC V’) giving the tax authorities access to information acquired through anti-money laundering rules.²⁸ The transposing period has elapsed as of 31st December 2017 and a new amendment (DAC VI) on automatic exchange of reportable cross-border arrangements has already been adopted.

The objective of external strategy (iv) is to secure effective taxation in relation to third countries. That is mainly tackled through national anti-avoidance measures, but these soft law documents stand as a complementary measure.²⁹ The strategy intends to enhance tax good governance cooperation and to assist developing countries in meeting tax good governance standards. It also develops a process for assessing and listing third countries depending on their tax governance standards.³⁰

²⁷ EUROPEAN PARLIAMENT, Deeper and fairer internal market with strengthened industrial base taxation. [Europarl.europa.eu](http://www.europarl.europa.eu) [online]. 2016 [visited on 2018-05-07]. Available at: <http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-recommendation-on-tax-treaties>

²⁸ EUROPEAN COMMISSION, Administrative cooperation in direct taxation in the EU. [online]. [Ec.europa.eu](http://ec.europa.eu). [visited on 2018-05-07]. Available at: https://ec.europa.eu/taxation_customs/business/tax-cooperation-control/administrative-cooperation/enhanced-administrative-cooperation-field-direct-taxation_en

²⁹ EUROPEAN PARLIAMENT, Deeper and fairer internal market with strengthened industrial base taxation. [Europarl.europa.eu](http://www.europarl.europa.eu) [online]. 2016 [visited on 2018-05-07]. Available at: <http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-external-strategy-for-effective-taxation>

³⁰ Blacklisted countries as of 13 March 2018 are American Samoa, Bahamas, Guam, Namibia, Palau, Samoa, Saint Kitts and Nevis, Trinidad and Tobago, US Virgin Islands. Up to date list is available at: https://ec.europa.eu/taxation_customs/tax-common-eu-list_en

1.4 CCCTB

The Common consolidated corporate tax base is a corporate income taxation scheme intended to lower administrative costs of supranational businesses operating in the common market and effectively preventing loss of tax revenue caused by transfer pricing. After the consolidation a formula would be used to distribute the tax base among involved Member States. Factors of equal importance determining the proportion of the tax base designated for a particular state are capital, labour and sales. Afterwards, each member state would apply its own tax rate on their share of the tax base maintaining a certain level of tax sovereignty. The Commission currently suggests a two-phase implementation of CCCTB. In the first phase, detailed rules for the calculation of the corporate tax base should be set (via the CCTB Directive) and the consolidation itself (CCCTB Directive) should only take place after the implementation of the first directive would be completed. Many questions arise regarding the procedural implementation of this approach. It would require maintenance of two separate systems of tax administration - one for the entities passing suggested threshold EUR 750 MIL of annual turnover that would be obliged to follow the consolidation regime, and another one for the rest of the companies still following the national framework.

This proposal is highly controversial and the adoption is uncertain. The main concern of member states is the restriction of autonomy in tax matters - a very sensitive topic. Once the system of tax administration is harmonized, the argument goes that harmonization of tax administration would eventually lead to harmonization or even unification of tax rates. Such a scenario is not desired by many states including the Czech Republic.³¹

³¹ Resolution of the Committee on European Affairs of the Chamber of Deputies of the Czech Republic No. 99. [online] psp.cz. 26 May 2011 [visited on 2018-05-07] Available at: www.psp.cz/sqw/text/orig2.sqw?idd=71321

2. Anti-Tax Avoidance Directive

In this chapter, I will first address some of the questions of more general nature that arise regarding it. Firstly, I will examine the legal bases for adoption of the instrument and briefly examine its compliance with the primary law of the EU, as some had already questioned it.³² As a legal form of the BEPS implementation has also been criticised as well as the methods used for the harmonisation, I will address these too. The Directive consists of five main measures - interest limitation rule, exit taxation, general anti-abuse rule, controlled foreign company rules, and rules on hybrid mismatches that will be discussed in more detail. The controversial switch-over clause, that prohibited tax exemption for profits derived from subsidiaries and permanent establishments located in low-tax jurisdictions that was initially part of the directive, was eventually removed.

2.1 Competence and Legal Form

The Member States are traditionally very reluctant to tax harmonisation especially in the field of direct taxes, as they consider them one of the core features of their sovereignty. The EU is not conferred with an exclusive competence in the tax matters.³³ The area rather falls within the scope of shared competences enumerated in Article 4 TFEU. In the field of shared competences, both the Union and the Member States may legislate and adopt legally binding acts in that area. Yet the Member States shall exercise their competence only to the extent that the Union has not exercised its competence.³⁴ The Article 115 provides that the ‘Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.’ The Article 5 (3) TEU requires that outside its exclusive competence, the Union shall only act if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States (...) but can rather by reason of the scale or effects of the proposed action be better

³² BROKELIND, Cécil, *The Anti-Tax Avoidance Directive and its Compatibility with Primary EU Law*. 2017. Master Thesis, Lund University, 2017

³³ Pursuant to the Article 3 of TFEU, the Union shall have exclusive competence in following areas:

- (a) customs union;
- (b) the establishing of the competition rules necessary for the functioning of the internal market;
- (c) monetary policy for the Member States whose currency is the euro;
- (d) the conservation of marine biological resources under the common fisheries policy;
- (e) common commercial policy

³⁴ Article 2 (2) TFEU

achieved at Union level. Article 5 (4) further provides that the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties. The principle of subsidiarity (Article 5 (3) TEU) has been already questioned by the national Parliaments of Sweden and Malta.³⁵ The Commission understandably argues that ATAD is in line with the principle of subsidiarity as it considers tax avoidance a problem directly affecting the internal market within the meaning of Article 115 TFEU. It also specifically points it out as grounds for the competence in the matter of ATAD Citations.

There were two other options for the implementation of BEPS measures - the ‘soft law’ peer review system and the hard law instrument of regulation based on Article 352 TFEU. The peer review instrument is applied through monitoring of the implementation introduced by the OECD in certain BEPS Action Plan documents and each Member State has an equal say.³⁶ The main difference between the legal instrument of regulation and directive is that directive sets certain aims, requirements, and concrete results that must be achieved by the Member States within a given transposing period, whereas regulation sets up immediately applicable and directly enforceable rules. The Commission is convinced that the implementation in a form of a directive is the most favourable option because of the substantial diversity of national tax systems and its conviction that the Member States are better placed to shape the specific elements of those rules in a way that fits their corporate tax systems the best.³⁷ Some authors criticise the implementation in a form of directive and claim that the peer review mechanism or a regulation would have been a better solution.³⁸

2.2 Scope of the Directive

The underlying aim of the Directive is to ensure that tax is paid where profits and value are generated.³⁹ The OECD’s BEPS instruments proposed to achieve this are the interest limitation rule, controlled foreign company rules, and rules on hybrid mismatches. The other two - the exit taxation rules and the general anti-avoidance rule go even beyond the OECD

³⁵ Malta claims that the Commission did not provide sufficient evidence that the implementation of BEPS measures through ATAD would not suffice at the Member State level, as Article 5 (3) TEU requires. CNS/2016/0011 - Maltese House of Representatives,” [online] ipex.eu [visited on 2018-06-05]. Available at: <http://www.ipex.eu/IPEXL-WEB/scrutiny/CNS20160011/mtkam.do>.

As referred to by BROKELIND, Cécil, *The Anti-Tax Avoidance Directive and its Compatibility with Primary EU Law*. 2017. Master Thesis, Lund University, 2017

³⁶ OECD, *Explanatory Statement 2015: Final Reports*, [online] oecd.org. 2015. [visited on 2018-06-05]. Available at: <http://www.oecd.org/ctp/beps-project-explanatory-statement-9789264263437-en.htm> p. 10–11

³⁷ (3) of ATAD Recitals

³⁸ See for instance DE GRAAF, Arnaud and VISSER, Klaas-Jan, *ATA Directive: Some Observations Regarding Formal Aspects*, *EC Tax Review* 97. 2016. p. 201. ISSN: 0928-2750

³⁹ (1) of ATAD Recitals

recommendations, which is a subject to criticism. The first objection is that the EU is voluntarily undermining its competitive position by implementation of additional rules that might hinder the business sector.⁴⁰ Another problem with this approach is the arguable creation of tax uncertainty for the MNE's as a result of an uncoordinated unilateral approach that BEPS was meant to prevent in the first place.⁴¹

Another aspect of the Directive related to the above-mentioned issues is its 'minimal level of protection' character. For further explanation, I will use the harmonisation theory of the European law⁴² that distinguishes (i) minimum harmonisation, (ii) alternative harmonisation, (iii) optional harmonisation and (iv) full harmonisation. The minimum harmonisation (i) approach sets up only the minimal standard that needs to be achieved and leaves the Member States with an option for stricter regulation on the matter. Alternative harmonisation (ii) gives the Member States a possibility to choose from several options alternatively. In the case of optional harmonisation (iii), the states are allowed to choose whether to opt-in for the proposed harmonisation or to stick with its current national legislation. As a result, both sets of the rules coexist together. The last option is the so-called full harmonisation (iv) that gives the states no choice but to apply the Unions measure in question. That practically leads to the unification of the area concerned.

The Directive uses a mixture of the methods explained above in particular measures, but the minimum harmonisation method is underlying the whole instrument. While this approach for harmonisation is understandable for the political delicacy of the area, it is not ideal due to its consequences. It by its nature creates space for a different form of regulation of the field in each Member State. CFE has expressed its concern that such an approach comes with a risk in some of the specific measures. It, for instance, argues, that it could lead to 28 different GAARs.⁴³ From the other point of view, the application of optional

⁴⁰ CFE, Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive. [online] taxadviserseurope.org. 2016. [visited on 2018-06-15]. Available online at: <http://taxadviserseurope.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC-3-2016-on-the-Anti-Tax-Avoidance-Directive.pdf> p. 3

⁴¹ Regarding this objection, Fung points out the testimony of Pascal Saint-Amans before the US Senate Committee on Finance: 'Unilateral action by countries on an uncoordinated basis, however, has the potential to replace the problem of non-taxation with the proliferation of uncoordinated legislative measures that will lead to excessive compliance costs for MNEs, as well as the potential for double or multiple taxation of the same income, undermining the existing consensus-based standards and replacing them with chaos. It also has the potential to encourage protectionist measures that would be detrimental to international trade.' (2014) FUNG, Sissie, The Questionable Legitimacy of the OECD/G20 BEPS Project. *Erasmus Law Review*, 2, 2017 p.77. DOI: 10.5553/ELR.000085

⁴² TICHÝ, Luboš, ARNOLD, Rainer, ZEMÁNEK, Jiří, KRÁL, Richard a DUMBROVSKÝ, Tomáš. *Evropské právo*. 5th Edition. Prague: C.H. Beck, 2014. p. 232.

⁴³ CFE, Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive. [online] taxadviserseurope.org. 2016. [visited on 2018-06-15]. Available online at:

harmonisation represented by allowed exemptions to some of the rules⁴⁴ could also be troublesome. The Member States considering applying them will surely be aware that they must be careful not to deliberately put themselves into a less competitive position. The CFE questions the proposed approach of minimal level of protection and argues that the method of full harmonisation would have been more appropriate as it would ensure unified legislation on the matter in the whole internal market providing more certainty for MNEs'.⁴⁵

2.3 Transposition

Even though the question of harmonisation of direct tax legislation is quite sensitive, the EU has been very active in the area and the Council has reached a political agreement on the ATAD in a surprisingly short period of less than five months⁴⁶, meaning that Directive 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market was adopted on the 12th of July 2016. Pursuant to Article 11, the transposition period elapses as of 31st December 2018 and the rules shall, therefore, be applicable from the 1st January 2019. There is a notable exception regarding the exit taxation rule, which affect is postponed and it shall come into force from 1st January 2020. It should be noted that the Council has already adopted an amendment - ATAD 2 - Council Directive 2017/952 amending Directive 2016/1164 as regards hybrid mismatches with third countries. ATAD 2 seeks to extend the scope of the ATAD 1 to third country situations and to include some missing measures from the BEPS Action 2 Report on imported mismatches, dual inclusion income, hybrid transfers, and reverse hybrid mismatches.⁴⁷ Deadline for the transposition of ATAD 2 has been set to 31st December 2019 and the measures shall come into effect one year later. As stipulated in Article 1, the scope of both directives shall be limited to corporate income tax.

<http://taxadviserseurope.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC-3-2016-on-the-Anti-Tax-Avoidance-Directive.pdf> p. 4

⁴⁴ Take the interest limitation rule for instance. The Directive gives Member States the option to allow for carrying forward of unused exceeding borrowing costs in under different conditions in Article 4 paragraph 6. The Member States will have to find balance between the foreseen gain in tax revenue and potential future losses caused by decrease in competitiveness. Ibid. p. 3

⁴⁵ Ibid. p. 4

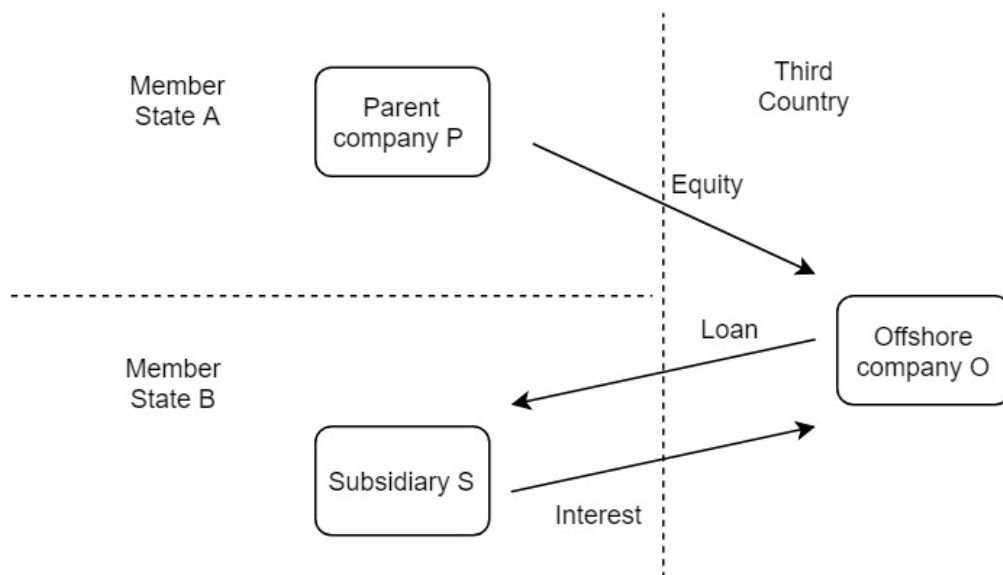
⁴⁶ BROKELIND, Cécil, *The Anti-Tax Avoidance Directive and its Compatibility with Primary EU Law*. 2017. Master Thesis, Lund University. p. 7

⁴⁷ FIBBE, G.K., STEVENS, A.J.A.. *Hybrid Mismatches Under the ATAD I. and II.. EC tax review*. 2017, Volume 26, Issue 3, p. 156. ISSN 0928-2750

2.4 Specific Measures

2.4.1 Interest Limitation Rule

Tax avoidance strategies often include debt tax planning strategies where interest and other deductible financial expenses are used to shift profits away from high tax countries to low tax ones. It is one of the simplest profit shifting strategies because of the mobility of money.⁴⁸ I will demonstrate a simple form with the scheme below.



Say that the Subsidiary S needs financing from its parent company. Rather than directly transferring equity the parent company P decides to use an offshore company O to provide a loan to Subsidiary S. Supposing the third country enforces little or no income tax, the interest paid to the company O will not be taxed as heavily as it would have been had the loan been provided directly by the company P. Thus, value is created for the group.

The Commission points out to different models in its Study of Aggressive Tax Planning and Indicators⁴⁹ but the abuse of interest deductibility is a characteristic feature. The interest limitation rule aims to neutralize effects of such arrangements by limiting taxpayers exceeding borrowing costs. Rules seeking to prevent the described phenomenon are also sometimes referred to as thin capitalisation rules. It was proposed in BEPS Action 4 and now adopted as one of the key instruments of ATAD. It should be noted that the structure of Article 4 of

⁴⁸ TELL, Michael. Interest Limitation Rules in the Post-BEPS Era, Intertax. 2017. Volume 45. Issue 11, p.750. ISSN 0165-2826

⁴⁹ EUROPEAN COMMISSION. Study on Structures of Aggressive Tax Planning and Indicators, final report, Taxation Papers, Working Paper n. 61 2015, ISSN 1725-7565.

the Directive strongly resembles, and is possibly derived, from the German rules on interest limitation.⁵⁰

The general rule set in Article 4 is that exceeding borrowing costs are only deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer's earnings before interest, tax, depreciation, and amortisation (EBITDA). The deductibility rate was chosen at the top of OECD's recommended scale (10 to 30%). For the purposes of the Directive exceeding borrowing costs mean the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law.⁵¹ It is also important to note that the term borrowing costs is broader than mere 'interest' and it covers interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in the national law, including, without being limited to:

- payments under profit participating loans,
- imputed interest on instruments such as convertible bonds and zero coupon bonds,
- amounts under alternative financing arrangements, such as Islamic finance,
- - the finance cost element of finance lease payments,
- capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest,
- amounts measured by reference to a funding return under transfer pricing rules where applicable,
- notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings,
- certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance,
- guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of funds.⁵²

An important feature of the instrument is the possibility to deduct exceeding borrowing costs up to EUR 3 MIL. According to the analysis carried out on the German interest limitation

⁵⁰ See LAMPERT, Steffen, MEICKMANN, Till, and REINERT, Maria. Article 4 of the EU Anti-Tax Avoidance Directive in Light of the Questionable Constitutionality of the German 'Interest Barrier' Rule. *European Taxation*, 2016, p. 323–27.

⁵¹ Article 2 (2) of ATAD

⁵² Article 2 (1) of ATAD

rule that is already in effect, the decision to incorporate this threshold will result in a majority of small and medium enterprises not being affected by the rule because their total payable interest (borrowing costs) will simply not reach the stipulated threshold.⁵³ On the other hand, if the Member States decide not to implement the deduction, small and medium enterprises might be overburdened.

There are two group ratio escape clauses in paragraph 5 of Article 5 that Member States can decide to implement. The first is a full deduction of exceeding costs if the taxpayer can demonstrate that the ratio of its equity over its total assets is no more than two percentage points lower than the equivalent group ratio. Alternatively, the taxpayers may be given the right to deduct exceeding borrowing costs in accordance with the group ratio of exceeding borrowing costs over EBITDA. The Member States are also allowed to exclude financial undertakings⁵⁴ from the scope of the rule due to the specific character of their activity, yet the intention is to ultimately conclude an interest limitation rule of broad scope, which is not subject to exceptions.⁵⁵

The interest limitation rule was criticised by the CFE for various ‘best practice’ provisions that Member States are not obliged to implement, but which they can opt to implement on a voluntary basis. I will address these in more detail in the chapter on implementation of the Directive into the Czech legal system. A diverse mixture of these in different Member States, CFE worries, will result in fragmented implementation creating uncertainty for businesses and stifling investment growth in the internal market.⁵⁶

2.4.2 Exit Taxation

The instrument of exit taxation is covered in Article 5 of the Directive. The rule is supposed to prevent profit shifting attempts of taxpayers moving their residence or assets to low-tax jurisdictions and thus avoiding taxation of profits which may have already been created

⁵³ TRUSEVIC, Andzej. Interest limitation and CFC rules in Anti-Tax Avoidance Directive, Tilburg University. Master Thesis, 2017

⁵⁴ The definition of financial undertaking can be found in Article 2 (5) and it includes regulated financial institutions like banks, insurance companies as well as pension funds, clearing houses or certain investment funds.

⁵⁵ EUROPEAN COMMISSION, Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market. 2016. p. 7.

⁵⁶CFE, Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive. [online] taxadviser europe.org. 2016. [visited on 2018-06-15]. Available online at: <http://taxadviser europe.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC-3-2016-on-the-Anti-Tax-Avoidance-Directive.pdf> p. 6

but not yet realised.⁵⁷ The taxpayer shall be subject to tax at a difference between the amount equal to the market value of the transferred assets at the time of exit of the assets and their value for the tax purposes. The rule covers three kinds of transfers - transfer of assets, business, and residence. Interestingly, the first proposal of the Directive did not clearly specify whether taxpayers were to be subject to exit taxation in every cross-border transfer, or only in the case when the Member State would lose the right to tax.⁵⁸ The Commission and the Council later redrafted the proposal and it is now clear that the exit tax is only applicable in the case of loss of a future taxation.

If the target of transfer or migration is another Member State or a state in the European Economic Area Agreement (EEA states), the taxpayers must be granted a right to defer the payment by paying it in instalments over five years. Member States may charge the taxpayer interest and require a security for the deferred amount. The rule also provides that the deferred amount becomes due immediately in case that

- a) the transferred assets or business carried in question are sold or otherwise disposed of,
- b) the transferred assets are subsequently transferred to a third country,
- c) the taxpayer's tax residence or business carried are subsequently transferred to a third country,
- d) the taxpayer goes bankrupt or is wound up,
- e) the taxpayer fails to honour his obligations in relation to the instalments.

The possibility to defer the payment ensures the application of exit taxation within the EU in compliance with the Fundamental Freedoms and Case Law of the CJEU.⁵⁹

Exit taxation may lead to double taxation if the country to which assets, business or residence is transferred does not use the same asset starting value for tax purposes as was used for exit tax purposes. Therefore, the exit tax provision includes a rule according to which the other state has to accept the exit tax value, if it is an EU Member State.⁶⁰

⁵⁷ EUROPEAN COMMISSION, Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market. 2016. p. 7

⁵⁸ CFE, Opinion Statement on the European Commission's Proposal for an Anti-Tax Avoidance Directive. [online] taxadviserseurope.org. 2016. [visited on 2018-06-15]. Available online at: <http://taxadviserseurope.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC-3-2016-on-the-Anti-Tax-Avoidance-Directive.pdf> p. 8

⁵⁹ EUROPEAN COMMISSION, Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market. 2016. p. 8

⁶⁰ HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p.202

2.4.3 GAAR

Article 6 of ATAD requires the Member States to implement the so-called general anti-abuse rule. It aims to close any gaps that could remain after the application of specific anti-avoidance instruments. The rule basically provides that arrangements or series of arrangements that have been made for the main purpose or one of the main purposes of obtaining a tax advantage that undermines the purpose of applicable tax law are not genuine and as such shall be ignored. The Directive later specifies that arrangements shall be regarded as non-genuine in case they are not put into place for valid commercial reasons which reflect economic reality.⁶¹

When an arrangement or a series of arrangements is ignored on the basis of GAAR, the national tax rules apply. As Helminem points out, the application of GAAR must not lead to a restriction in the basic TFEU freedoms. It is also important to note, that based on the EU Court case law, the risk of tax avoidance justifies the application of an anti-avoidance provision in a restrictive manner only in the case of wholly artificial tax avoidance arrangements.⁶²

We can distinguish GAAR from specific anti-avoidance rules (SAARs). SAAR's are targeted at narrow, specific areas where abuse has been previously identified or revenue leakage is suspected. Often, SAARs are tied to or inserted into a specific section of a nation's revenue code. However, the SAAR's weakness is its specificity. Additionally, the SAAR is further abated by the fact that it is easily avoided and incorporated into new avoidance activities.⁶³

An EU level GAAR was already proposed for the first time in Article 80 of the CCCTB proposal in 2011 and the current re-launched CCCTB scheme also includes GAAR in Article 58. The wordings of ATAD GAAR and CCCTB GAAR are almost identical. The GAAR adopted sets a minimum standard and therefore avoids a run towards the lowest standard. Other benefits are not discernible as a uniform GAAR would be differently applied by the different courts of the states.⁶⁴

2.4.4 Controlled Foreign Company Rules

The rule on controlled foreign company is divided into Article 7 and 8. Article 7 sets up the qualification of entities that have to be treated as CFCs in Member States

⁶¹ Article 6 paragraph 2 of ATAD

⁶² HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 203

⁶³ LOUTINSKY, Genevieve. Gladwellian Taxation: Deterring Tax Abuse through General Anti-Avoidance Rules, 12 Hous. Bus. & Tax L.J. 82. 2011. p. 85

⁶⁴ FRANZ, Tobias. The General Anti-Abuse Rule Proposed by the European Commission. Intertax. 2015. Volume 43. Issue 11, p. 672 ISSN 0165-2826

and Article 8 lays down the minimum requirement of the tax consequences of a CFC.⁶⁵ A form of ATAD CFC rules corresponds to those proposed in OECD BEPS Action 3.⁶⁶ The CFC rule gives Member States the right to attribute profits shifted from taxpayers to controlled companies in low tax jurisdictions. The parent company is consequently taxed for attributed income and thereby the tax avoidance scheme is neutralised. The CFC measure basically aims to eradicate the incentive of shifting income, so that the income is not taxed at a low rate in another jurisdiction.⁶⁷

Entities or permanent establishments will be qualified as taxpayers' CFC in case following conditions are met:

- a) an entity, the taxpayer by itself, or together with its associated enterprises holds a direct or indirect participation of more than 50 percent of the voting rights, or owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of that entity; and
- b) the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment.

The second requirement has the effect of an entity or permanent establishment being qualified as a CFC of a taxpayer if it is subject to an effective tax rate of less than 50% of the effective tax rate applicable in the Member State of the taxpayer.⁶⁸

The ATAD gives the Member States two alternative options to determine CFC income attributable to the taxpayer. Helminem calls the first one the *Income category approach*.⁶⁹ It demands the Member States to include income of the entity or permanent establishment that is derived from the following categories:

⁶⁵ HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 203

⁶⁶ See OECD, Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report. [online] oecd.org. 2015. [visited on 2018-06-31] Available at: <http://www.oecd.org/publications/designing-effective-controlled-foreign-company-rules-action-3-2015-final-report-9789264241152-en.htm>

⁶⁷ EUROPEAN COMMISSION, Proposal for a Council Directive Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market. 2016. p. 9

⁶⁸ DE BRAUW, EcoFin Council adopts Anti-Tax Avoidance Directive (ATAD) without switch-over clause, debrauw.com [online] 2016. [Visited on 2018-07-05] Available at: <https://www.debrauw.com/newsletter/ecofin-council-adopts-anti-tax-avoidance-directive-atad-without-switch-clause/>

⁶⁹ HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 204

- a) interest or other income from financial assets
- b) royalties or other income from intellectual property
- c) dividends or capital gains on shares
- d) income from financial leasing
- e) income from banking, insurance and other financial activities
- f) income from invoicing associated enterprises for goods and services while the CFC adds little or no economic value.⁷⁰

The measure shall not apply in case the CFC in question is able to prove that it is actually performing substantive economic activity supported by staff, equipment, assets, and premises. Furthermore, Member States may exempt CFC whose income from the defined categories does not exceed one-third of its total income, and that are financial undertakings and whose income from the defined categories resulting from transactions with the taxpayer or associated enterprises does not exceed one-third of its total income.⁷¹

The second option is the so-called *Non-genuine arrangement approach*.⁷² It entails a similar test of arrangement genuineness as the above-mentioned GAAR. In other words, it requires inclusion of non-distributed income derived from non-genuine arrangements or series of arrangements that were put in place for the essential purpose of obtaining a tax advantage.⁷³

The Member States may decide to exclude an entity or permanent establishment from the scope of the provision that either:

- a) has accounting profits of no more than EUR 750 000 and non-trading income of no more than EUR 75 000, or
- b) of which accounting profits amount to no more than 10% of its operating costs for the tax period.⁷⁴

There are separate rules for computation of CFC income for each of the above-described approaches. As long as the *income category approach* is applied, the income to be included in the tax base of the taxpayer shall be calculated in accordance with the rules of the corporate tax law of the Member State where the taxpayer is resident for tax purposes or

⁷⁰ Art 7(2) Anti-Tax Avoidance Directive.

⁷¹ DE BRAUW, EcoFin Council adopts Anti-Tax Avoidance Directive (ATAD) without switch-over clause, *debrauw.com* [online] 2016. [Visited on 2018-07-05] Available at: <https://www.debrauw.com/newsletter/ecofin-council-adopts-anti-tax-avoidance-directive-atad-without-switch-clause/>

⁷² HELMINEM, Marjaana. *EU Tax Law - Direct Taxation*. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 205

⁷³ Art 7(2) Anti-Tax Avoidance Directive.

⁷⁴ Art 7(4) Anti-Tax Avoidance Directive.

situated. Losses of the entity or permanent establishment shall not be included in the tax base but may be carried forward, according to national law, and taken into account in subsequent tax periods. In the case of the *non-genuine arrangement approach* the income included in the tax base shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company. The attribution of controlled foreign company income shall be calculated in accordance with the arm's length principle.⁷⁵⁷⁶ If the taxpayer has only limited participation in the entity in question, the income included in its tax base shall be calculated in proportion to the rate of its participation. The rule also aims to prevent unwanted double taxation and, therefore, in case the taxpayer disposes of its participation in the entity or of the business carried out by the permanent establishment, and any part of the proceeds from the disposal previously has been included in the tax base as CFC income, that amount shall be deducted from the tax base when calculating the amount of tax due on those proceeds.⁷⁷

2.4.5 Hybrid Mismatches

Hybrid mismatches are the consequence of differences in the characterization of payments on financial instruments or of entities under the tax systems of two jurisdictions. Such hybrid mismatches may lead to a double deduction (i.e. deduction in both states) or a deduction of the payment in one state without inclusion of the corresponding income in the tax base of the other. To neutralize the effects of hybrid mismatch arrangements, it is necessary to lay down rules whereby one of the two jurisdictions in a mismatch situation should deny the deduction of a payment leading to such an outcome.⁷⁸

As mentioned above, the part of ATAD addressing the hybrid mismatches has already been amended in May 2017 by Council Directive 2017/952. The main objective of the Amendment was to broaden the scope of the measure to hybrid mismatches involving third countries and to cover some forms of hybrid mismatches that have previously not been included. In this thesis, I will examine the amended version of the Directive. Amended rules on hybrid mismatches shall be, unlike the rest of the measures, implemented by the Member States by 31st December 2020 and by 31st December 2021 for reverse hybrid mismatches

⁷⁵ Art 8(1) Anti-Tax Avoidance Directive.

⁷⁶The Arm's length principle provides, that intragroup transfers are deemed to be carried out under the same conditions and at the same prices as independent parties would have applied under similar circumstances. HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 242

⁷⁷ Ibid. p. 206

⁷⁸ Ibid. p. 207

respectively.⁷⁹ There are several kinds of hybrid mismatches that are now addressed by the amended ATAD:

- a) *hybrid entity mismatch* occurs when an entity is considered a taxable entity under the laws of one country and whose income or expenditure is treated as income or expenditure of one more other person under the laws of another jurisdiction.⁸⁰
- b) *hybrid financial instrument mismatch* is a result of different legal qualifications of the same financial instrument under different jurisdictions. If the character of the payment qualifies it for double tax relief under the laws of the payee jurisdiction, such as an exemption from tax, a reduction in the rate of tax or any credit or refund of tax, the payment should be treated as giving rise to a hybrid mismatch to the extent of the resulting undertaxed amount.⁸¹
- c) *hybrid transfers* could give rise to a difference in tax treatment if, as a result of an arrangement to transfer a financial instrument, the underlying return on that instrument was treated as derived by more than one of the parties to the arrangement. In those cases, the payment under the hybrid transfer could give rise to a deduction for the payer while being treated as a return on the underlying instrument by the payee.⁸²
- d) *hybrid permanent establishment mismatches* occur where differences between the rules in the jurisdictions of permanent establishment and of residence for allocating income and expenditure between different parts of the same entity give rise to a mismatch in tax outcomes and include those cases where a mismatch outcome arises due to the fact that a permanent establishment is disregarded under the laws of the branch jurisdictions.⁸³
- e) *imported mismatches* shift the effect of a hybrid mismatch between parties in third countries into the jurisdiction of a Member State through the use of a non-hybrid instrument thereby undermining the effectiveness of the rules that neutralise hybrid mismatches.⁸⁴
- f) *dual residence mismatches* could lead to a double deduction if a payment made by a dual resident taxpayer is deducted under the laws of both jurisdictions where

⁷⁹ Article 2(1), (3) of ATAD 2.

⁸⁰ HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 209

⁸¹ Recitals (16) of ATAD 2.

⁸² Recitals (23) of ATAD 2.

⁸³ Recitals (10) of ATAD 2.

⁸⁴ Recitals (25) of ATAD 2.

the taxpayer is resident. A Member State is under certain circumstances given the right to deny duplicated deduction.^{85a}

The Directive comes with specific rules that are supposed to neutralize effects of the above-mentioned hybrid mismatches providing that in case the hybrid mismatch results in a double deduction, the deduction shall be denied in the Member State that is the investor jurisdiction. If that is not the case, the deduction denial shall occur in the payer jurisdiction.⁸⁶ Similarly, it provides rules for deduction denials in cases of deduction without inclusion.

⁸⁵ Article 9b of ATAD 2.

⁸⁶ HELMINEM, Marjaana. EU Tax Law - Direct Taxation. 2017. Amsterdam, IBDF, ISBN 978-90-8722-428-8 p. 210

3. Implementation of ATAD into the Czech Legal System

In this chapter, I will firstly address the implementation proposal as a whole. Consequently, I will focus on the implementation of specific measures and their evaluation.

3.1 General Remarks

ATAD is supposed to prevent tax avoidance of MNEs, and it specifically states that the scope of the directive is limited to Corporate income tax⁸⁷. The Czech corporate income tax is together with the personal income tax covered by the Act No. 586/1992 Sb. on Income Taxes (Furthermore also referred to as ‘CITA’ derived from the Czech Income Tax Act).⁸⁸ The current Czech system of direct taxation has been designed in the early 1990s and since then it has been amended more than 150 times and it is therefore a rather complicated piece of legislation. Some members of the Legislative Council of the Government even called it the most convoluted Act in the Czech legal system.⁸⁹ The works on the new tax act are already in progress, but it will not be ready before the year 2020 and therefore the Directive will be implemented into the current legislative framework, mostly the above-mentioned Income Tax Act. Another norm in question will be the Act No. 280/2009 Sb. Tax Procedure Code used to transpose the General Anti-Abuse rule.

The somewhat controversial feature of the Czech ATAD implementation is, that it was put forward into a legislative process together with amendments of many other acts as one bigger package.⁹⁰ According to the Ministry of Finance, the logic behind this was to simplify the legislative process, make it more efficient, and bring more clarity and transparency into yearly changes in the tax-related legislation to make it more comprehensible for the taxpayers.⁹¹ This was criticised by the Governments Legislative Council as well as by the Czech Bar Association in their opinions on the proposal. Such approach is breaching the Article 39

⁸⁷ Article 1 ATAD

⁸⁸ In Czech ‘Zákon č. 586/1992 Sb. o daních z příjmů’

⁸⁹ For instance, JUDr. Josef Vedral, Ph.D. or Mgr. František Korbela Ph.D.. EPRAVO.CZ, 10 Otázek pro... [online]. epravo.cz. 2011, 2014. [visited on 2018-07-19]. Available at: <https://www.epravo.cz/top/aktualne/10-otazek-pro-frantiska-korbela-73532.html> and <https://www.epravo.cz/top/aktualne/10-otazek-pro-josefa-vedrala-93523.html>

⁹⁰ The whole package also includes changes in following legislation:

Act No. 187/2016 Sb. on Gambling Tax,

Act No. 235/2004 Sb. on VAT,

Act No. 353/2003 Sb. on Excise Duties,

Act No. 242/2016 Sb. on Customs,

Act No. 164/2013 Sb. on International Cooperation in Tax Administration,

Act No. 456/2011 Sb. on Czech Financial Administration and

Act No. 17/2012 Sb. on Czech Customs Administration.

⁹¹ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

paragraph 4 of Legislative Rules of the Government that lays down that acts, including the amending ones, shall not cover matters that are not directly linked to each other.⁹² The author is convinced that the ‘bundle’ approach is a more suitable option as in practice it is often difficult to successfully get amending acts through the legislative procedure within the implementation deadline, and several independent proposals would only further complicate the matter. Furthermore, the objection to the Article 39 by the Government’s Legislative Council is more or less of a formal nature and the Council itself does not hold a strong opinion on the issue, informally suggesting the proposer to propose a change of the Legislative Rules of the Government themselves.⁹³

The Explanatory Memorandum refers to Article 3 of the Directive, mentioning its ‘minimum level of protection’ nature. The Directive, contrary to other directives adopted under 115 TFEU regime,⁹⁴ differs in the harmonisation approach by not implementing full harmonisation yet the minimal standards. The maximal level of protection is therefore only limited by the national law and EU primary law, the second mostly concerned with maintaining protection of freedoms of movement of persons, services, capital, and payments.⁹⁵ The general principle underlying the implementation proposal is the protection of fiscal interests of the Czech Republic with respect to simplicity of application on sides of both the tax administration and the taxpayers. The proposal also tries not to undermine the position of Czech taxpayers with regard to their EU competition and is not intended to create an unnecessary burden.⁹⁶

The expected impact on the corporate income tax revenue is difficult to predict, yet the conservative estimates of the Czech Ministry of Finance counts with a figure not exceeding CZK 200 MIL (circa EUR 7.7 MIL). Half of this increase is attributed to the interest limitation rule and the other one to the CFC measures, with the rest having a very little or hardly predictable effect due to the lack of relevant data. The implementation will also require modification of the IT system used by the Tax Administration, resulting in one-time costs around tens of millions of CZK. No significant costs for the taxpayers are predicted.⁹⁷

⁹² See Opinion of Government’s Legislative Council No. 350/18 from 2018-06-8. and Opinion of Czech Bar Association No. 07.31-000001/18 on Changes of Acts in Taxes and Other Acts from 2018-03-05.

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⁹³ Personal consultation with Doc. JUDr. Radim Boháč, Ph.D. on 26 July 2018.

⁹⁴ See chapter 2.1.

⁹⁵ Explanatory Memorandum to the Government’s proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

⁹⁶ Ibid.

⁹⁷ Ibid.

3.2.1 Interest Limitation Rule

As specified in the previous chapter, the aim of the interest limitation rule is to neutralize effects of base erosion caused by debt financing. The Czech Income Tax Act already includes a specific rule on thin capitalization. Traditional thin capitalization rules consist of implementation of a safe harbour rule disallowing the tax deduction of interest payments to related parties if internal debt exceeds a specified debt-to-equity ratio.⁹⁸ That is also the case of the Czech general thin capitalization rule that limits tax deductibility of borrowing expenses among affiliated entities⁹⁹ in Sec. 25 (1) w). Current specific limitations are laid down by Sec. 25 (1) zk) and zl). According to letter zk) the parent entities are not allowed to deduct expenses incurred to reach, secure and maintain the income within the meaning of Section 24 CITA related to possession of share in subsidiaries. Letter zl) prohibits deduction of financial expenses connected to financial credit instrument, where the interest or proceeds are dependent on profits of the debtor. Aim of this provision is to prevent substitution of payment of the share of profit by payment of interests from credit instruments.¹⁰⁰ In this regard, the current legislation already constitutes a stricter regime than is demanded by the ATAD.¹⁰¹

The proposed implementation of the interest limitation rule leaves the above-mentioned provisions in place and adds two new Sections to the CITA, namely Section 23e setting the rule itself and Section 23f enumerating legal forms to be exempted from it. The transposition is characterised as minimalistic by the proposer, rarely putting forward any stricter measures than a necessary minimum harmonisation. The following scheme made by Hyršl illustrates Czech interest deductibility rules that will be in effect after the implementation comes into force.¹⁰²

⁹⁸ DORADO, Ana Paula. The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle. *EC Tax Review*. 2017. Volume 26. Issue 3. p. 112-113. ISSN: 0928-2750.

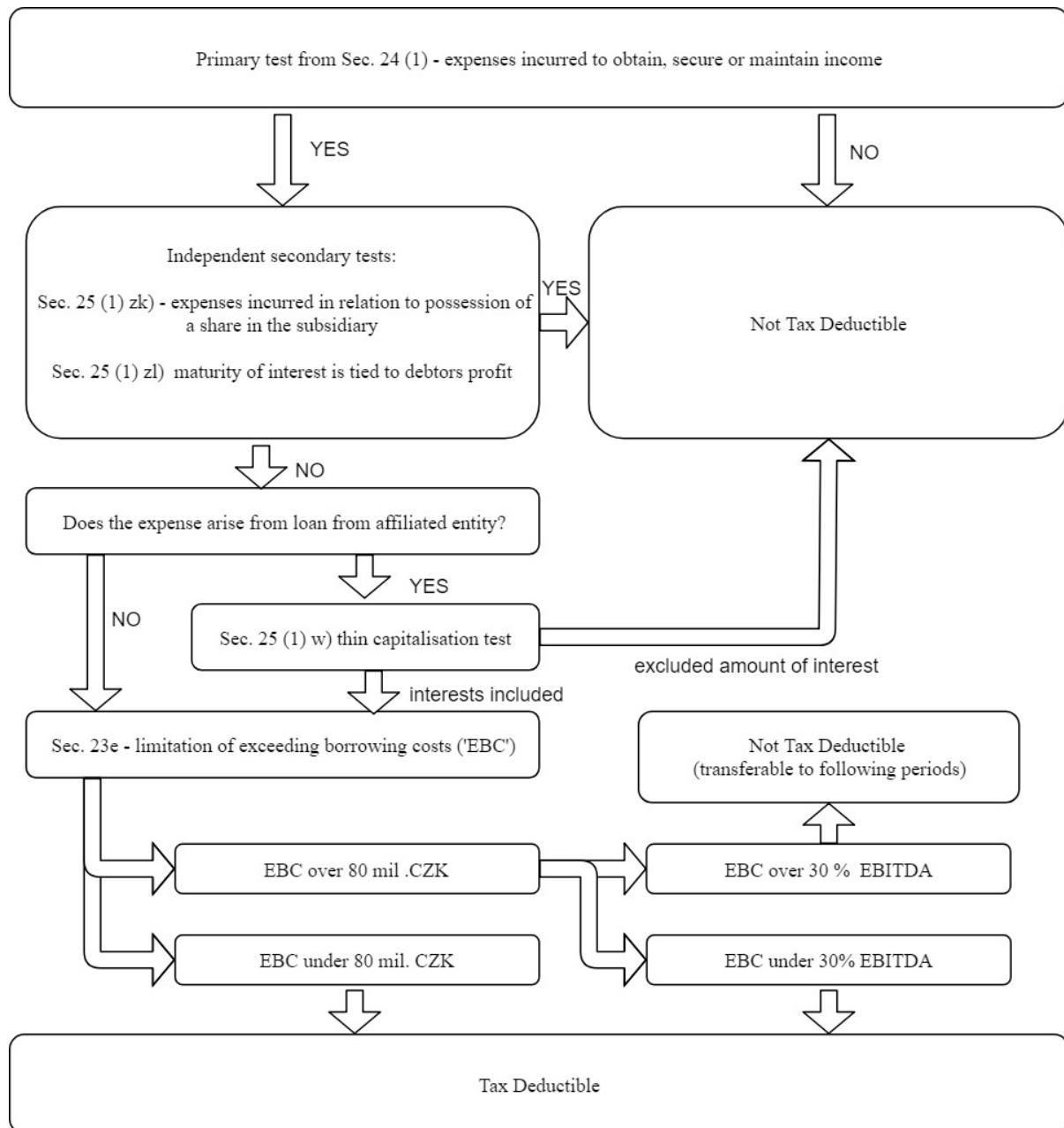
⁹⁹ The definition of Affiliated Entities (in Czech 'Spojených osob') can be found in Article 23, paragraph 7 of CITA.

¹⁰⁰ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

¹⁰¹ BOHÁČ, Radim. HRDLIČKA, Lukáš. Transpozice směrnice ATAD do právního řádu České republiky. *Daně a účetnictví: Expertní příspěvky*. dauc.cz [online] 2018. [visited on 2018-04-02] ISSN: 2533-4484 Available at: <https://www.dauc.cz/dokument/?modul=li&cislo=242158> p. 2.

¹⁰² Translated from HYRŠL, Adam. *Pravidlo nízké kapitalizace - směrnice ATAD. (Thin Capitalization Rule - ATAD) 2018*. Bachelor Thesis, University of Economics, Prague. p. 24

Tax Deductibility of Borrowing Costs after ATAD Implementation:



The transposition of the rule is designed to increase economic results¹⁰³ that serve as a foundation for determination of the tax base according to Section 23 CITA. According to the first paragraph of the proposed Section 23e, the taxpayer's economic results are increased by the positive difference between exceeding borrowing costs and the limit on borrowing costs deductibility that accounts to higher of the amounts:

- a) 30 % of taxable earnings before interest, tax, depreciation, and amortisation,
- b) CZK 80 MIL¹⁰⁴

The limit is purposely set almost at the top of the line so that businesses would not be unnecessarily burdened by it. The decision will, however, also result in very few entities exceeding it and therefore the rule itself will have little or no effect in the Czech context.¹⁰⁵ The second paragraph defines exceeding borrowing costs for the purposes of the income tax as expenses incurred to reach, secure and maintain the taxable income, after deduction of borrowing incomes for a given taxation period.

In the third paragraph, the definition of borrowing costs is set. The definition uses the Directives enumeration that can be found in the previous chapter while adjusting it to CITAs terminology.¹⁰⁶ While the explanatory memorandum qualifies the list as exhaustive, it seems arguable as the letter h) provides that expenses similar to those enlisted before should fall within the category.¹⁰⁷ Borrowing income is defined in paragraph 4 as income in form of interest from the financial credit instruments and income equivalent to expenses under paragraph 3, mirroring the borrowing costs as approved by Hrdlička and Boháč.¹⁰⁸

The fifth paragraph defines 'taxable earnings before interest, tax, depreciation, and amortisation' as necessary for computation of the sum by which the tax base has to be increased pursuant to paragraph 1. As the explanatory memorandum clarifies, the concept of EBITDA is commonly understood as an accounting term based on accounting items and as such it differs from the concept used in Article 4 paragraph 2 ATAD, based on tax items.

¹⁰³ Czech equivalent being 'Výsledek hospodaření'.

¹⁰⁴ Calculation of the limit is based on the proposed limit of 3 000 000 EUR using exchange rates as of 2016-06-12 and the amount was rounded from 81 105 000 CZK.

¹⁰⁵ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

¹⁰⁶ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁰⁷ The proposer explains this as a manifestation of the general anti-abuse rule.

¹⁰⁸ BOHÁČ, Radim. HRDLIČKA, Lukáš. Transpozice směrnice ATAD do právního řádu České republiky. Daně a účetnictví: Expertní příspěvky. dauc.cz [online] 2018. [visited on 2018-04-02] ISSN: 2533-4484 Available at: <https://www.dauc.cz/dokument/?modul=li&cislo=242158> p. 3

Taxable earnings before interest, tax, depreciation, and amortisation for the given tax period, therefore, consist of the sum of the following items:

- a) economic results or the difference between income and expenses adjusted under CITA except for adjustments made due to limitations on deductibility of exceeding borrowing costs,
- b) tax bases subject to withholding tax at specific tax rate,
- c) a separate tax base subject to tax rate within the scope of Section 24 (4) CITA,
- d) depreciation of assets applied as an expense incurred to reach, secure and maintain taxable income,
- e) positive valuation difference on the acquisition of a business or a positive difference between the valuation a business acquired by the acquisition and aggregate worth of its individually valued items lowered by any assumed debts applied as expenses incurred to reach, secure and maintain taxable income; and
- f) exceeding borrowing costs

The Ministry of Finance decided to implement Article 4 (6) of the Directive, which allows taxpayers to carry forward, without time limitation, exceeding borrowing costs which could not be deducted in the current tax period. This option is provided by paragraph 6 of Section 23f and is aimed to prevent an unfair disadvantage to taxpayers who only have exceeding borrowing costs in a certain time period, as they do not intend to avoid taxation but rather use the debt financing for the purpose of further investments.¹⁰⁹

In the following provision, Article 23f CITA, exemptions to the interest limitation rule are enlisted. The decision to implement exclusion of financial undertakings can be perceived as positive, as the opposite approach would likely be troublesome for the financial sector that is of specific nature. Even the Commission has acknowledged that it would require a more customised approach.¹¹⁰ In fact, the default setting of the Directive has been criticised for not making the exclusion financial undertakings obligatory.¹¹¹

The financial undertakings excluded are:

- a) banks,
- b) savings and credit cooperatives,

¹⁰⁹ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

¹¹⁰ (9) of ATAD Recitals

¹¹¹ GINERVA, Guglielmo. The EU Anti-Tax The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level. 2017. Intertax. Volume 45. Issue 2, p. 121, ISSN: 0165-2826

- c) professional dealers in securities,
- d) insurance undertakings,
- e) reinsurance undertakings,
- f) pension insurance institutions
- g) the funds of pension companies,
- h) investment funds or sub-funds of limited liability company with variable capital under the Act No. 240/2013 Sb. on Investment Companies and Investment Funds or similar foreign funds,
- i) investment companies managing investment funds,
- j) central counterparties in accordance with directly applicable EU regulation on OTC derivatives, central counterparties and trade repositories,
- k) central depositories under a directly applicable EU regulation on improving securities settlement in the European Union and on central securities depositories; or
- l) taxpayers who do not have
 - i) an affiliated person defined for the purposes of taxation of controlled foreign company
 - ii) permanent establishment¹¹²
 - iii) the obligation to submit consolidated financial statements under accounting rules and is not a consolidating entity under the accounting rules

The implementation does not include any other optional provisions that are suggested by the Directive. Articles 1 and 5 of the Directive regarding the consolidated groups are not implemented due to the fact that CITA does not allow consolidated taxation. Furthermore, the rules were considered too complicated and it was claimed that their transposition would require the gathering of information about the whole group, which could be difficult especially in the case of parent entities resident in states that do not share the tax information with the Czech Republic. The exemption to the interest limitation rule suggested in Article 4 (4) regarding long-term public infrastructure projects that was not implemented in order to avoid redundant complexity of the amendment and alleged administrative costs on the side of the taxpayer required to prove that the financial instrument in question is in fact directly connected to a long-term public infrastructure project.¹¹³

¹¹² Within the meaning of Article 22, paragraph 2 of CITA

¹¹³ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

Similar reasoning was used for not implementing the exception concerning the loans concluded before 17th June 2016 from exceeding the borrowing costs calculation. It was argued that exclusion of loan agreements would imply inconsistent approach towards different means of financing. There is, however, a transitional provision stipulating, that specific interests included in the remaining book value of assets before the 17th June 2016 will be exempt to simplify administration. The proposed version of the interest limitation rule can be perceived as minimalistic, attempting to put as little additional burden on the taxpayers as possible while fulfilling the Directives requirements. Except for the increase of tax liability of taxpayers, we can also expect an increase in administrative costs on both the sides of the taxpayers and tax administration. The chosen approach was also recommended by the RIA, which clearly favoured the minimalistic version over the considered more restrictive one.¹¹⁴ According to analysis from UEP, a positive influence on the capital structure of enterprises and their indebtedness can also be expected. A possibly obvious advantage of the newly implemented rules is the prevention of tax avoidance by debt financing abuse.¹¹⁵

3.2.2 Exit Taxation

The authors of the implementation had decided to use a longer, but more informative denomination for the measure and named the institute ‘Taxation of the transfer of property without change of ownership’.¹¹⁶ The instrument based on Article 5 of ATAD is also implemented through CITA, adding new Section 23g. The implementation works with legal fiction that a transfer of assets is looked upon as a sale of the assets to itself. Section 23g specifically provides, that the transfer of assets without change of ownership from the Czech Republic abroad is for income tax purposes considered a paid transfer to an entity itself, for a price that would be agreed upon between unrelated entities in regular business relations under the same or similar conditions. In other words, it applies the Arm's length principle on intragroup cross-border asset transfers. The economic results or the difference between revenue and expenses for CIT purposes shall be adjusted accordingly.

The second paragraph explains which situations are to be considered a transfer of assets without change of ownership:

¹¹⁴ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p. 19

¹¹⁵ HYRŠL, Adam. Pravidlo nízké kapitalizace - směrnice ATAD. (Thin Capitalization Rule - ATAD) 2018. Bachelor Thesis, University of Economics, Prague. p. 30

¹¹⁶ In Czech ‘Zdanění při přemístění majetku bez změny vlastnictví’. Alternative translation of Exit tax instrument would be ‘Zdanění při odchodu’.

- a) Transfer of assets of a taxpayer who is a tax resident of the Czech Republic from the Czech Republic to his permanent establishment situated abroad, if as a result of this transfer, the method of exemption¹¹⁷ would be used to avoid double taxation arising from this transfer
- b) Transfer of assets of a taxpayer who is not a tax resident, from permanent establishment situated in the Czech Republic abroad if as a result of this transfer income obtained in relation to subsequent paid transfer of these assets were not to be subject to tax liability in the Czech Republic.
- c) Transfer of assets associated with relocation of tax residence of a taxpayer from the Czech Republic abroad, had such transfer resulted with income from subsequent paid transfer not being subject to tax liability in the Czech Republic.

The following provision of paragraph 3 provides the exemption for paid transfers to an entity itself where it can be reasonably expected that the assets will be transferred back to the Czech Republic within 12 months, and the transferred assets are:

- a) related to financing of securities
- b) provided as financial collateral or
- c) to comply with the statutory requirement of capital adequacy or liquidity risk management

The option to pay the exit tax in instalments stipulated by Article 2 (2) of the Directive is transposed into Section 38zg CITA as a possibility for deferral and distribution of tax payments under the Tax Procedure Code. These provisions are incorporated to ensure compliance with the case law of Court of Justice of the EU developed in the context of the proportionality test of the fundamental freedoms. Therefore, the right is only granted in cases of intra-EU relocations or relocations to a third country that is part of the EEA to the extent that an applicable agreement regarding the mutual assistance for the recovery of tax

¹¹⁷ In Czech ‘vyněti’. If this method is used, income from the source abroad is not included into the tax base of the taxpayer in his home country. An alternative is the credit method (in Czech ‘započtení’) when the home state of the taxpayer includes incomes from both domestic and foreign sources, determines the tax and consequently deduces the tax paid abroad from home tax liability.

KARFÍKOVÁ, Marie et al. *Teorie finančního práva a finanční vědy*. 2018. Prague: Wolters Kluwer ČR. p.163 ISBN: 978-80-7552-935-0

claims is in place that is equivalent to the mutual assistance provided for in the Mutual Assistance Directive.¹¹⁸

Generally, the ATAD form of exit taxation instrument does not allow for much discretion for the Member States to implement and, therefore, the regulatory impact assessment only considered not implementing the measure versus the version described above. As the first option would constitute a breach of constitutional requirement to fulfil obligations arising from international law and the EU law, it was claimed there was no other choice but to opt for the latter.¹¹⁹ Unlike the rest of the measures, the implementation of exit tax should come into effect as of 1st June 2020. Peeters attributes the postponing of the measures effect by a year to the recent shift from case law regarding the question whether and under which conditions the Member States may impose exit taxes on unrealized capital gains, to a directive prescribing that the Member States have to subject such unrealised capital gains to an exit tax.¹²⁰

3.2.3 GAAR

The Implementation of the General Anti-Abuse Rule from Article 6 of the Directive is perhaps the most controversial part of the proposal. It is intended to be a complementary instrument to the rest of the introduced specific anti-avoidance rules. There was a great deal of discussion about whether it is necessary to even implement the rule, as some argued it was already implicitly present in the Czech legal system through the case law established interpretation of the general principle of prohibition of abuse of rights. I will address developments in these discussions in more detail after examining the proposal itself. It was eventually decided to implement GAAR by adding a new provision to the part of the Tax Procedure Code providing for general principles of tax administration. Namely, there is a fourth paragraph added to Section 8, concerning the substance over form principle. The wording of the added provision is as follows:

‘Tax administration will not take into account juridical acts and other facts decisive for administration of taxes, predominant purpose of which is to obtain a tax advantage contrary to the purpose and intended objective of the tax legislation.’

¹¹⁸ PEETERS, Steven. Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool. 2017. EC Tax Review. Volume 26. Issue 3. p. 130 ISSN: 0928-2750

¹¹⁹ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p. 24

¹²⁰ PEETERS, Steven. Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool. 2017. EC Tax Review. Volume 26. Issue 3. p. 132 ISSN: 0928-2750

The initial version of the proposal did not include the ‘decisive for administration of taxes’ specification and it was argued by the Chamber of Tax Advisors that such approach would result in even stricter GAAR than required by the Directive.¹²¹ The specification was added after these objections. Similarly, the specification of ‘tax’ legislation had to be added only after concerns about applicability of GAAR in case of violation of other areas of the law that would lead to an outcome inconsistent with the case law of the Supreme Administrative Court.¹²²

There is also one other change in the procedural part of the Tax Procedure Code regarding the examination of evidence adding a letter f) to Section 92, paragraph 5 providing that the Tax Administration carries the burden of proof regarding:

‘the facts decisive for the assessment of the purpose of juridical acts and other facts decisive for the administration of taxes, predominant purpose of which is to obtain a tax advantage contrary to the purpose and intended objective of the tax legislation.’

This provision is explicitly putting the burden of proof on the side of the tax administration in terms of examination of evidence in assessment of purpose and intent of juridical acts and other facts in question.¹²³

The Chamber of Tax Advisors, as well as the Czech Bar association, both agreed there was no need to transpose the Article 6 whatsoever, as the Czech legal system already included the anti-abuse measure in the form of a general principle forbidding the abuse of rights. The doctrine was developed by the Supreme Administrative Court and it is being followed since the decision of 10th November 2005 Sp. zn. 1 Afs 107/2004 where the Court concluded that donations dedicated to the association, when the sole purpose of the donation was the reduction of the tax base, was an unacceptable abuse of right.¹²⁴ Similar reasoning was applied in the decisions zn. 9 Afs 57/2015 or 4 Afs 137/2016 and its use of the principle was also confirmed by the Constitutional Court in resolution sp. zn. II. ÚS 2714/07 stating that

¹²¹ Opinion of Czech Chamber of Tax Advisors on Changes of Acts in Taxes and Other Acts proposal from 2018-03-02. p.48

¹²² The Czech Chamber of Tax Advisors argued with an illustrative situation where marketing practice was proven to be an expense within the meaning of Sec. 24 (1) but would be considered a violation of consumer protection provisions or a competition law would therefore not be considered tax allowable expense. Ibid. p. 48

¹²³ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹²⁴ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p. 49

‘although the financial law does not explicitly define the abuse of rights principle, this does not mean that the abuse of rights or circumvention could not occur in this area of law, nor that this conduct could not be identified as such with the result of adequate legal consequence.’¹²⁵

The European Court of Justice assesses the abuse of rights for the purposes of EU law via test consisting of two parts - objective and subjective elements have to be established. The first, objective, element has been set out in a quite clear manner. It reflects what was more or less implicitly stated in the previous case law. The person claiming to have the right is barred from invoking it only to the extent to which the Community law provision formally conferring that right is relied upon for the achievement of an improper advantage, manifestly contrary to the objective of that provision.¹²⁶ The subjective element consists of the intention to obtain an advantage from the Community rules by artificially creating the conditions laid down for obtaining it.¹²⁷ The case law of the Supreme Administrative Court confirms these conclusions and adopts them.¹²⁸

Due to the above-mentioned case law, it was thought that the GAAR was implicitly present in the Czech legal system and there was no need to implement the measure explicitly. Even the discussion material regarding ATAD implementation presented by the Ministry of Finance in March 2017 did not plan for an amendment of the Tax Procedure Code.¹²⁹ The decision has later been changed as the European Commission did not approve this form of ‘implementation’ when a similar measure was in question with regard to the implementation of the Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. Such approach was not considered sufficient and the Commission insisted on explicit provision, and this stance had to be taken into consideration for the ATAD implementation as well.¹³⁰

¹²⁵ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p. 50

¹²⁶ BOBIĆ, Ana. Prohibition of Abuse of Rights in the EU. 2011. University of Zagreb. Thesis. p. 13

¹²⁷ ECJ - Case C-110/99, Emsland-Starke, cit., para. 52 and 53

¹²⁸ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p.50

¹²⁹ It specifically stated that ‘The Ministry of Finance assumes that the general rule against abuse under Article 6 of the Directive will not be explicitly included in the Income Tax Act or any other legal regulation. The rule is an implicit part of the Czech legal system and will continue to be used in administrative and judicial practice, as is the case until now, without explicit provision providing for it.’

MINISTRY OF FINANCE. Implementace směrnice EU proti vyhýbání se daňovým povinnostem do českého právního řádu - podklad pro veřejnou konzultaci. [online] mfc.cz. 2017. [visited on 2018-07-26]. Available at:<https://www.mfc.cz/cs/o-ministerstvu/verejne-diskuze/2017/verejna-konzultace-implementace-smernice-28011> p. 16

¹³⁰ Personal consultation with Doc. JUDr. Radim Boháč, Ph.D. on 26 July 2018.

Given the GAAR had to be explicitly transposed, the authors of the proposal had three options:

- a) limit the rule to corporate income tax,
- b) limit the rule to corporate income tax and personal income tax or
- c) not to limit the rule and apply it to all taxes within the meaning of the Tax Procedure Code.¹³¹

Options a) and b) could potentially decrease the level of legal certainty as their implementation would lead to differentiation of the explicit anti-abuse rule for CIT or the whole CITA and the case law established prohibition of the abuse of rights applying on the rest of the taxes.¹³² Therefore, the controversial c) option was chosen. The Czech Bar Association objected that such approach was an example gold-plating, or in other words, exceeding the requirements of the EU legislation when transposing directives into national law, as the ATAD GAAR was only required for CIT administration. The proposal was therefore labelled as an attempt for boundless extension of tax administrations authorization.¹³³

Further objection of the Czech Chamber of Tax Advisors was that this wide scope of applicability of GAAR could interfere with the case law of the European Court of Justice that defines the abuse of rights in the VAT area. It was therefore argued that this could potentially result in discriminatory conditions for certain taxpayers.¹³⁴ These objections were dismissed with the claim that the proposed GAAR is in a way itself arising from ECJ case law, and is therefore in line with it and the case laws earlier conclusions will still be relevant for the proposed GAARs application.

In relation to this, it should be mentioned that the proposed wording of Sec. 8 (4) was criticised for not corresponding to the wording of Article 6 ATAD according to which arrangements targeted are those of ‘main purpose of which or one of the main purposes of’ is obtaining a tax advantage. As one can see above, the Czech transposition is slightly different, aiming at arrangements ‘predominant purpose’ of which is to obtain a tax advantage.¹³⁵ One of the reasons for this word choice is an attempt of the legislator to preserve the term used in the case law on the matter and thereby ensure continuity and prevent interpretations different

¹³¹ BOHÁČ, Radim. HRDLIČKA, Lukáš. Transpozice směrnice ATAD do právního řádu České republiky. Daně a účetnictví: Expertní příspěvky. dauc.cz [online] 2018. [visited on 2018-04-02] ISSN: 2533-4484 Available at: <https://www.dauc.cz/dokument/?modul=li&cislo=242158> p. 6

¹³² Ibid.

¹³³ Opinion of Czech Bar Association No. 07.31-000001/18 on Changes of Acts in Taxes and Other Acts from 2018-03-05.

¹³⁴ Opinion of Czech Chamber of Tax Advisors on Changes of Acts in Taxes and Other Acts proposal from 2018-03-02. p.49

¹³⁵ In Czech original ‘hlavním důvodem nebo jedním z hlavních důvodů’ vs. ‘převažující účel’.

from those established. In addition to that, authors of the proposal criticise the use of the phrase ‘main purpose of which or one of the main purposes of’ as self-contradictory from the logical perspective.¹³⁶ They also claim that the ‘predominant purpose’ terminology emphasizes the substance more clearly, focusing on the fact that the purpose is really essential or fundamental. The argument goes, that this will also allow the tax administration prosecute cases of abuse of rights, where the taxpayer intentionally sets up the facts in a way that obtaining of a tax benefit contrary to the purpose and intended objective of the tax legislation will not be the only main purpose of the conduct, but will after a complex assessment of particular motivations remain the predominant (essential) purpose.¹³⁷ The author is of the opinion that a slight change in the wording and perhaps broadening of the tax administrations competence is an acceptable trade-off for the perseverance of the case law and maintaining legal certainty.

The last notable objection to the proposed version of GAAR was a concern regarding retroactivity. The Czech Chamber of Tax Advisors was concerned about the proposed rules on abuse of rights being broader than the case law established ones, and therefore a change in a legislation regulating procedure of tax administration, could retroactively affect and potentially sanction conduct, procedures or agreements that were in compliance with the legislation in effect in the given tax period.¹³⁸ This concern was dismissed after changes in the wording of the proposal were introduced and the taxpayers were assured that the GAAR was just a codification of already established rules, without broadening of the concept.

The author supports the proposed form of GAAR, mostly due to the fact that the codification of already established principle will not result in further complication of the tax system, and might, in fact, contribute to more legal certainty for taxpayers not necessarily aware of the case law. As it is not possible to preserve the current state due to the fact that the Commission does not qualify such form of implementation as sufficient, the option to implement the measure as a general rule into the Tax Procedure Code seems to be the least disputable option.

¹³⁶ It is either true that the main one can be only one of the objects and therefore it is pointless to talk about several main objects (the existence of two or more would be contradictory) or, on the other hand it is possible to have more main objects, yet then it would be sufficient to use one inclusive term ‘main’ the rest being pleonasm. Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹³⁷ Ibid.

¹³⁸ Opinion of the Czech Chamber of Tax Advisors on Changes of Acts in Taxes and Other Acts proposal from 2018-03-02. p.49

3.2.4 Controlled Foreign Company Rules

The purpose of the controlled foreign company rules is to neutralise the effect of harmful preferential tax regimes and tax havens. It does so by requiring the Member States to ensure that CIT taxpayers include incomes of their subsidiaries or permanent establishments that are subject to CIT in jurisdictions in preferential tax regimes into their tax bases.¹³⁹ The following provisions implement Articles of 7 and 8 of the Directive.

Like the rest of the measures except from GAAR, CFC rules are to be covered in part of CITA on general provisions, though at the very end of it, in Section 38fa headlined ‘Taxation of controlled foreign company’.¹⁴⁰

The first paragraph is creating legal fiction, where activities and management of assets resulting in income of a controlled foreign company are, under certain circumstances, looked upon as if they occurred in the Czech Republic:

‘For the purposes of income taxes, the activities of the controlled foreign company and the management of its assets from which included income arises, shall be regarded as if they were conducted by the controlling company in the territory of the Czech Republic at the time of the ending of tax period of the controlled foreign company if

- a) controlled foreign company is not engaged in any significant economic activity and
- b) tax similar to corporate income tax
 - i) of a foreign controlled company that is a CIT taxpayer in the state in which it is a tax resident is less than half the tax that would be imposed on it if it were a tax resident in the Czech Republic
 - ii) of a controlling company in the state, in which the permanent establishment that is a controlled foreign company is situated, is less than half the tax that would have been set if the activities of the permanent establishment and the management of its assets were carried out in the territory of the Czech Republic.’

The purpose of these conditions is to limit application of the rule to so called empty shell entities, without genuine economic activity, whose tax paid is significantly lower compared to what would have been due in the Czech Republic. When ascertaining the whether

¹³⁹ BOHÁČ, Radim. HRDLIČKA, Lukáš. Transpozice směrnice ATAD do právního řádu České republiky. Daně a účetnictví: Expertní příspěvky. dauc.cz [online] 2018. [visited on 2018-04-02] ISSN: 2533-4484 Available at: <https://www.dauc.cz/dokument/?modul=li&cislo=242158> p. 7

¹⁴⁰ In Czech ‘Zdanění ovládané zahraniční společnosti’.

the condition is fulfilled, effective tax is taken into account.¹⁴¹ Considering that CFC can either be a foreign taxpayer subject to tax similar to CIT or a permanent establishment of Czech tax resident located in a foreign jurisdiction, the letter a) is divided into two subcategories covering the way of assessing of CFC's tax.¹⁴²

Definition of controlling and controlled companies can be found in the second and third paragraph respectively. CITA amendment proposal defines a controlling company as a Czech tax resident who is

- a) directly or indirectly participating in the capital of a controlled foreign company or if it itself or together with its associated enterprises fulfils one of the conditions set out in paragraph 3 letter a) points 1 and 2 (share of capital, voting rights or profits)
- b) whose permanent establishment is a controlled foreign company (within the meaning of a consequent paragraph)

Controlled foreign company is defined as

- a) a CIT taxpayer who is not a Czech tax resident for CIT purposes, in the case of Czech tax resident alone or together with associated entities
 - i) holds a direct or indirect participation of more than 50 % of the capital or voting rights
 - ii) is entitled to receive more than 50 % of the profits
- b) a permanent establishment of a taxpayer who is a tax resident of the Czech Republic, located in a state with which the Czech Republic has concluded a treaty on avoidance of double taxation which is part of the legal system and according to which double taxation is avoided by the method of exemption.

The Czech Republic applies the principle of taxation of worldwide income of its tax residents. In case there is a treaty on avoidance of double taxation between the state, where the permanent establishment is located and the Czech Republic and method of exemption is applied, earnings of the permanent establishment are exempted from the tax base of taxpayer in the Czech Republic. Therefore, the permanent establishments in states towards which the exemption method is applied, must be looked upon as CFCs.¹⁴³

¹⁴¹ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

¹⁴² Ibid.

¹⁴³ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

Associated entities¹⁴⁴ are defined in paragraph 4. New term had to be introduced in order to cover the requirements of the Directive. The definition refers to Sec. 23 (7) CITA that provides for already established term used by CITA - capital related entities¹⁴⁵. This term was not sufficient as the conditions for its application are only participation on 25 % of capital or voting rights, and the Directive required a broader concept, that would also include entitlement to receive 25 % of the profit, and as such it had to be introduced.¹⁴⁶ The concept is also referred to by the provisions covering the implementation of hybrid mismatches measures.¹⁴⁷

The Directive allows the Member States to choose out of two ways to determine incomes that should be included in controlling companies tax base. The Member States could either use income category approach or non-genuine arrangement approach described in the previous chapter. The authors of the proposal decided for the income category approach that will entail income:

- a) in the form of borrowing income¹⁴⁸,
- b) in the form of royalties
- c) from profit share
- d) from the loss of the share in the CIT taxpayer
- e) from the assignment of property for use for consideration with subsequent gain of such property for consideration by a party to the obligation
- f) from insurance, banking and other financial activities
- g) from the sale of goods and provision of services purchased from associated entities and sold to associated entities with little or no added economic value
- h) from the sale of goods or provision of services to associated entity whose activity consists mostly from sale of goods and services a subsequent sale of such goods and provision of services to associated entities with little or no added economic value

The letter e) is intended to cover incomes arising from financial leasing agreements. However, it is defined in a very narrow manner, for the purposes of CITA, and therefore a broader description was chosen, covering also other instruments of similar economic nature. Letters g)

¹⁴⁴ In Czech 'přidružené osoby'.

¹⁴⁵ In Czech 'kapitálově spojené osoby'

¹⁴⁶ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁴⁷ In Section 23h (5).

¹⁴⁸ Borrowing income is described in the part of thesis concerning interest limitation rule (3.2.1).

and h) are supposed to prevent the use of so called ‘billing companies’ the main purpose of which is shifting of profits to lower tax jurisdiction.¹⁴⁹

The author considers choice of the income category approach a more suitable option and agrees with the arguments expressed in RIA, that the non-genuine arrangement approach would have been create legal uncertainty and unnecessary administrative burden on sides both of the taxpayer and the tax administration, as each transaction would have to be individually assessed.¹⁵⁰

Paragraph 6 sets out the extent to which the controlling company may be attributed the income of a CFCs. The extent of attributed activity and management of assets is determined in proportion to the share in the registered capital of the CFC. Paragraph 7 prevents situations, where the inclusion of CFCs activities would result in lowering of controlling company’s economic results. If a CFC ends up in a loss, the economic results of the controlling company cannot be lowered by this amount. Furthermore, the paragraph 8 allows the controlling company to set the its tax liability in the Czech Republic to a tax similar to CIT by paid by the CFC in another state. Understandably, only to the extent to which the foreign tax was arising from the activities and management of the assets that attributed to the controlling company, using the simple credit method.¹⁵¹

The Directive gave the Member States an option to introduce some exemptions to the rules, for instance for entities whose included income would only account for one third of their income or for financial undertakings under certain circumstances. The possibility to implement these exemptions was not used as it was argued that in the light of generally applicable exemption based on substantial economic activity test, these would be redundant and by their introduction there would still be certain incentives to shift passive profits to low tax jurisdictions and the fiscal interests of the Czech Republic would not be protected sufficiently.¹⁵² The author considers these concerns legitimate and generally considers the proposed form of CFC rules reasonable.

¹⁴⁹ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁵⁰ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p. 30

¹⁵¹ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁵² Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

3.2.5 Hybrid Mismatches

Originally ATAD only included a definition of hybrid mismatches in the Article 2 and two short provisions in Article 9 providing in which state the deductions should be denied. After the ATAD 2 Amendment, there are several more provisions to be implemented, namely Article 9, and added Articles 9a and 9b in conjunction with the adjusted definition of hybrid mismatches in Article 2. Even though the transposition deadlines are delayed regarding the amended hybrid mismatches measures, the authors of the proposal decided to already transpose the amended version. Such approach should be valued as another redundant CITA amendment that was avoided.

The measure is transposed via the above-mentioned CITA, adding a new Section 23h, headlined ‘Addressing the consequences of different legal qualification’.¹⁵³ Systematically, it is put in the third part of CITA concerning general provisions, together with the interest limitation rule and exit tax measures. There already is a measure concerning one kind of hybrid mismatch in the second part of CITA, regarding the CIT, that is a result of the implementation of Council Directive 2014/86/EU of 8th July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. It is focused on hybrid credit instruments, where loan or equity is considered a tax-deductible expense in the state of the payer and at the same time it is considered a tax-exempt distribution of profit in the state of the beneficiary. The Sec. 19 (1) zi addresses these cases, providing that share of a profit taken by the parent company in the Czech Republic is not exempted from taxation if tax reduction is possible for the subsidiary.¹⁵⁴

The Section 23h is based on the use of the defensive rule. The defensive rules are of primary and secondary nature, where the primary rule covers the situation of double deduction and the secondary one covering deduction without inclusion.¹⁵⁵

The first paragraph consists of the primary rule in the following wording:

‘If, as a result of the different legal classification of legal fact, the expense or other item lowering the economic results or the difference between income and expenses lowers the tax

¹⁵³ In Czech ‘Řešení důsledků rozdílné právní kvalifikace’. A direct translation of Hybrid Mismatches (‘Hybridní nesoulady’) was considered, but eventually refused by the Government’s Legislative Council as possibly unintelligible. Personal consultation with Doc. JUDr. Radim Boháč, Ph.D. on 2 August 2018.

¹⁵⁴ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

¹⁵⁵ BOHÁČ, Radim. HRDLIČKA, Lukáš. Transpozice směrnice ATAD do právního řádu České republiky. Daně a účetnictví: Expertní příspěvky. dauc.cz [online] 2018. [visited on 2018-04-02] ISSN: 2533-4484 Available at: <https://www.dauc.cz/dokument/?modul=li&cislo=242158> p. 8

base of associated entity more than once and in relation to that multiple deduction, there is no multiple inclusion of corresponding income to the tax base of such associated entities, the economic results or the difference between income and expenses of a CIT taxpayer, who is such an associated entity shall be increased, by the amount corresponding to the lowering of the tax base if

- a) the state in which this item is created or has a source (hereinafter referred to as the ‘State of source’) is not the Czech Republic; or
- b) the State of source is the Czech Republic and the state in which the tax base reduction related to this item occurs does not apply the rule similar to the one set by this paragraph.’

The first paragraph is covering hybrid mismatches resulting in double deduction by associated entities, in relation to tax-deductible expenses, or other items lowering the economic results. The authors of the implementation consider states other than the Czech Republic, that may use a different element for construction of the tax base than expenses or other items lowering the economic results that lead to lowering of the tax base and therefore formulation ‘if lowers the tax base of associated entities more than once’ is used.¹⁵⁶

The second paragraph covers situations where the hybrid mismatches result in deduction without inclusion on the side of the associated entity in a similar manner. It can be described as a transposition of the secondary defensive rule. The letter a) covers cases where the associated entity in the Czech Republic lowers its tax base, providing that such expense is not tax-deductible, unless the corresponding income is attributed to the associated entities tax base. A typical example is the situation, where one state considers a payment a tax-deductible expense and the second state considers it a tax-exempt income.¹⁵⁷

The letter b) deals with instances where an expense incurred outside the territory of the Czech Republic is a tax-deductible in that jurisdiction while being a tax-exempt item under the Czech tax law and the state in question does not apply measures similar to those discussed.

The third paragraph is specifying what is to be considered an income included in the tax base for the purpose of hybrid mismatch measures. Legal fiction of inclusion of income is created if it has been included in the tax base of the taxpayer in a tax period beginning no later than 12 calendar months after the end of the tax period or the period for which the tax return is

¹⁵⁶ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁵⁷ Ibid.

made, in which the expense occurred. Alternatively, in the case of financial instruments, the income may be considered as included in case it can be reasonably expected that such income will be included in a future tax period, but only if the terms of the financial instrument correspond to those that would be negotiated by unrelated entities (in accordance with the Arm's length principle).¹⁵⁸ The fourth paragraph sets up a subsidiary rule for cases of imported hybrid mismatches described in the previous chapter.

The last provision defines what is meant by an associated entity¹⁵⁹ for the purpose of provisions regarding addressing the consequences of different legal qualification. The definition can be found in part of the proposal covering the controlled foreign company rules in Sec. 38fa (4). The difference being, threshold for capital, voting rights or earnings is adjusted to 50% and the concept is further broadened to include otherwise related entities¹⁶⁰, CIT taxpayers and their permanent establishments.

The author appreciates that the measures will not result in double taxation as only the difference between expenses (other items lowering the economic results) that lead to lowering of the tax base and corresponding incomes will be included in the tax base. Otherwise, double taxation would occur.¹⁶¹

There are several other provisions in ATAD 2 that are not transposed through the government's proposal. The reason for this is that some of the rules are rather specific with regard to special characteristics of tax systems of particular Member States.¹⁶² These include Article 9 (5) concerning the so-called disregarded permanent establishments. It aims at situations where foreign incomes are exempted from the tax base on the basis of setting up of a permanent establishment. The Czech CITA does not stipulate for such exemptions and the provision is therefore not transposed. The case of Article 9 (6) is similar, as it tries to cover the issue of jurisdictions that do not apply to the institute of beneficial owner to dividends or interests.¹⁶³

¹⁵⁸ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁵⁹ I translate the term from Czech 'přidružená osoba'. The directive uses term 'associated enterprise', or in Czech - 'přidružený podnik'.

¹⁶⁰ In Czech 'jinak spojené osoby' within the meaning of Sec. 23 (7) b) of CITA.

¹⁶¹ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. Specific Part

¹⁶² BOHÁČ, Radim. HRDLIČKA, Lukáš. Transpozice směrnice ATAD do právního řádu České republiky. Daně a účetnictví: Expertní příspěvky. dauc.cz [online] 2018. [visited on 2018-04-02] ISSN: 2533-4484

Available at: <https://www.dauc.cz/dokument/?modul=li&cislo=242158> p. 8

¹⁶³Ibid. p.9

Article 9a regarding reverse hybrid mismatches is not transposed as the difference in the legal qualification of entities will not arise due to the fact that the Czech CIT system is based on the concept of taking over of foreign legal qualification so that discrepancies should not arise.¹⁶⁴ Similar reasoning was used for not transposing of Article 9b regarding the dual tax residence mismatches. One of the fundamental principles of CITA is that only expenses incurred to reach, secure and maintain an income are tax deductible. It is therefore not possible that an expense unrelated to such income would be a tax deductible in this regard.¹⁶⁵

It is worth noting, that the issue of hybrid mismatches is not very significant from the Czech perspective, as this area is mostly already dealt with in the treaties for the avoidance of double taxation. The measures are neither expected to be significant from the perspective of budgetary consequences.¹⁶⁶

¹⁶⁴ Explanatory Memorandum to the Government's proposal from 2018-06-13 on Changes of Acts in Taxes and Other Acts. General Part

¹⁶⁵ Ibid.

¹⁶⁶ Regulatory Impact Assessment on Changes of Acts in Taxes and Other Acts. p. 33

Conclusion

The aim of this thesis was to introduce ATAD in its historical context and to describe and evaluate the proposed version of implementation as a measure of the fight against tax avoidance. The social demand for action against tax avoidance that was rising after the financial crisis was further strengthened in the light of scandals like the Panama Papers. The evidence of tax avoidance being a problem that largely affects global CIT revenues is strong and comes from various reliable sources. Discrepancies in tax systems of different states, as well as the existence of tax havens and harmful preferential tax regimes constitute an environment where tax avoidance is possible. The OECD's Action Plan on BEPS has introduced a bundle of 15 Actions with the intention to tax profits where economic activities take place and where value is created. The European Commission has put itself to the forefront in the fight against tax avoidance and its proposals often go further than OECD's recommendations. The Anti-tax avoidance Directive represents only a part of its anti-tax avoidance efforts, together with several soft law documents, international exchange of information in the field of taxation based on DAC Directives, or the proposal of CCCTB. The author generally supports these efforts and considers them appropriate for the correction of the system.

The ATAD consists of five measures intended to neutralize the effects of tax avoidance practices, or in other words, to prevent erosion of the CIT base and the shifting of profits to jurisdictions enforcing little or no tax liabilities. As the Directive has to be applicable in 28¹⁶⁷ different jurisdictions, and since it draws inspiration from existing provisions, some forms of the measures are already in effect in some of the Member States. ATAD explicitly states that its intention is minimum harmonisation of anti-avoidance rules. Apart from the exit taxation and GAAR, which exceed the requirements, the ATAD is an attempt for coordinated European implementation of OECD's BEPS measures. One of the criticisms of BEPS that the author identifies with is the issue of questionable democratic legitimacy and competence of OECD to design the global tax environment as the perspective of developed economies might differ from the developing ones. Objections regarding the use of minimum harmonisation, that may arguably result in further discrepancies, are in the authors opinion not very convincing, considering political reality and variety in the tax systems among the Member States.

¹⁶⁷ The UK is also implementing ATAD. More information available on the British Government's website. Policy paper - Hybrid and other mismatches Anti-Tax Avoidance Directive. gov.uk [online]. 2018. [visited on 2018-07-30]. Available online at: <https://www.gov.uk/government/publications/hybrid-and-other-mismatches-anti-tax-avoidance-directive/hybrid-and-other-mismatches-anti-tax-avoidance-directive>

The first proposed measure is the **interest limitation rule**. It is intended to prevent the use of debt financing as a form of tax avoidance by limiting the amount of the tax-deductible borrowing costs that an entity is allowed to claim. However, the exclusion of exceeding borrowing costs up to CZK 80 MIL, set not to overburden most of the taxpayers, will result in only the largest entities being affected by the measure. The second measure is an **exit taxation rule**. It requires the Member States to tax unrealised appreciation of assets based on the difference between the amount equal to the market value of the transferred assets at the time of exit of the assets and their value for tax purposes. The **general anti-abuse rule** is designed as a complementary instrument towards the rest of the measures. It provides that arrangements main purpose of which is to obtain a tax advantage shall be regarded as non-genuine in case they are not put in place for valid commercial reasons and as such shall be ignored by the tax authority. **Controlled foreign company rules** set up conditions under which controlled entities in foreign low-tax jurisdictions are taxed in certain circumstances, which prevent the use of the so-called shell entities that do not perform any genuine economic activity. The last of the measures aims to neutralise the effects of **hybrid mismatches** by laying down rules for the treatment of differing legal qualifications that result in double deductions or deductions without inclusions of corresponding incomes.

The ATAD is transposed into the Czech legal system through CITA and the Tax Procedure Code. The implementation is rather minimalistic, aiming not to create an unnecessary burden for the taxpayers nor the tax administration. The authors of the proposal therefore seldom use measures that would go beyond the proposed minimum level of protection. The budgetary impact of ATAD will not likely be very significant, with conservative estimates of an CIT revenue increase of CZK 200 MIL. The implementation fulfils the requirements of the Directive and follows a logical structure within the limits of CITA. The most controversial feature of the proposal from the author's perspective is the implementation of GAAR through the Tax Procedure Code and its applicability to the administration of all taxes, contrary to the fact that ATAD is specifically limited to CIT. However, as it is, in fact, a codification of the current case law, and other options would be even more problematic, the author supports the proposed solution. In general, the author does not find any major shortcomings in the proposal, that is in accordance with the recommendations of the regulatory impact assessment.

As most of the measures will come into effect in 2019, there will be an opportunity for additional research on the application of the instruments. We can also expect future development in the area on both OECD and EU levels, that will provide material for further

analysis. The author is also curious about the actual economic impact of the measures, as the taxpayers avoiding their tax liabilities are probably already contemplating ways for tax optimisation under the upcoming rules.

List of Abbreviations

ATAD – Anti-tax Avoidance Directive

CITA – Czech Income Tax Act

CIT – Corporate Income Tax

CCCTB – Common Corporate Consolidated Tax Base

DAC – Directive on Administrative Cooperation

EPRS – European Parliamentary Research Service

GAAR – General Anti-Abuse Rule

IMF – International Monetary Fund

MNE – Multi-National Enterprise

OECD – Organisation for Economic and Cultural Development

SAAR – Specific Anti-Abuse Rule

UNCTAD – United Nations Conference on Trade and Development

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Implementace ATAD

Abstrakt

Cílem této práce je popsat a zhodnotit implementaci směrnice proti vyhýbání se daňovým povinnostem (ATAD) do českého právního řádu. Práce představuje problematiku vyhýbání se daňovým povinnostem i její rozsah a definuje základní pojmy jako je vyhýbání se daňovým povinnostem (tax avoidance), daňový únik (tax evasion), daňový ráj a škodlivý preferenční daňový režim. Autor následně popisuje historické kořeny směrnice, Akční plán OECD proti rozpadu daňového základu a přesouvání zisků a další opatření, která jsou implementována na úrovni EU, jako je mezinárodní výměna informací v oblasti daní na základě směrnice DAC, nebo návrh CCCTB.

Ve druhé kapitole je prezentována samotná směrnice ATAD. Jejím základem je pět opatření, jejichž cílem je zamezit účinkům praktik využívaných k vyhýbání se daňovým povinnostem, jinými slovy k rozpadu daňového základu a přesouvání zisků. Prvním navrhovaným opatřením je pravidlo omezení odečitatelnosti úroků. Jeho smyslem je znemožnit dluhové financování jako formu vyhýbání se daňové povinnosti, skrze omezení daňově uznatelných výpůjčních nákladů, které mohou daňový poplatník uplatňovat. Druhým opatřením je pravidlo zdanění při odchodu, které vyžaduje, aby členské státy danily zhodnocení aktiv na základě rozdílu mezi částkou rovnající se tržní hodnotě převáděného aktiva v okamžiku přesunu a jejich hodnotou pro daňové účely.

Obecné pravidlo proti zneužívání daňového režimu je navrženo jako doplňkové opatření k ostatním nástrojům. Stanoví, že pokud ujednání, jejichž převažujícím účelem je získat daňovou výhodu, nemají ekonomické opodstatnění, správce daně k nim nepřihlíží. Pravidla pro ovládané zahraniční společnosti stanovují podmínky zdanění ovládaných zahraničních společností v jurisdikcích s nízkým efektivním zdaněním. Smyslem je omezit využívání takzvaných "schránek", neboli společností, které nevykonávají skutečnou ekonomickou činnost. Pravidla na řešení hybridních nesouladů mají zabránit vyhýbání se daňovým povinnostem prostřednictvím zneužívání rozdílných právních kvalifikací vedoucích ke dvojímu daňovému odpočtu nebo odpočtu bez zahrnutí odpovídajícího příjmu.

Třetí kapitola je věnována návrhu implementace směrnice ATAD do českého právního řádu. K transpozici dochází skrze zákon o dani z příjmu a daňový řád. Implementace je spíše minimalistická, s cílem zabránit zbytečné zátěži na straně poplatníků, tak i daňové správy. Autor při rozboru návrhu, který je v souladu s doporučeními z hodnocení dopadů regulace, nenarazil na žádné podstatnější nedostatky.

Klíčová slova: ATAD, Implementace, Vyhýbání se daňovým povinnostem

Implementation of ATAD

Abstract

The aim of the thesis is to describe and evaluate the Czech implementation of Anti-Tax Avoidance Directive (ATAD). It firstly introduces the problem of tax avoidance, its scale and defines basic concepts such as tax avoidance, tax evasion, tax havens and harmful preferential tax regimes. The author consequently describes origins of the Directive, OECD's Base Erosion and Profit Shifting Actions and other measures that are being implemented on the EU level such as international exchange of information in the field of taxation based on DAC Directives, the proposal of CCCTB.

In the second chapter the ATAD is presented. It consists of five measures intended to neutralize the effects of tax avoidance practices, or in other words, to prevent erosion of the CIT base and the shifting of profits to jurisdictions enforcing little or no tax liabilities. First measure proposed is the interest limitation rule. It is intended to prevent the use of debt financing as a form of tax avoidance by limiting the amount of the tax-deductible borrowing costs that an entity is allowed to claim. Second measure is the exit taxation rule that requires the Member States to tax unrealised appreciation of assets based on the difference between amount equal to the market value of the transferred asset at the time of exit of the assets and their value for tax purposes. The general anti-abuse rule is designed as a complementary instrument towards the rest of the measures. It provides that arrangements main purpose of which is to obtain a tax advantage shall be regarded as non-genuine in case they are not put in place for valid commercial reasons and as such shall be ignored by the tax authority. Controlled foreign company rules set up conditions under which controlled entities in foreign low-tax jurisdictions are taxed in certain circumstances, which prevent the use of the so-called shell entities that do not perform any genuine economic activity. Rules on hybrid mismatches prevent tax avoidance by laying down rules for the treatment of differing legal qualifications that result in double deductions or deductions without inclusions of corresponding incomes.

The third chapter is dedicated to proposed implementation of ATAD into the Czech legal system. The transposition will be done by the amendments of Czech Income Tax Act and Tax Procedure Code. The implementation is rather minimalistic, aiming not to create an unnecessary burden for the taxpayers nor the tax administration. Generally, the author did not find any major shortcomings in the proposal, that is in accordance with the recommendations of the regulatory impact assessment.

Key words: ATAD, Implementation, Tax Avoidance