



**30 January 2015**

## **Anti- offshore changes to the EU Directive on Parent and Subsidiary companies: what will change as of 2016**

Dear colleagues, please find below brief analysis of the important changes to the Council Directive of the European Community "On the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States" (Council Directive 2011/96 / EU, hereinafter - the Directive).

In accordance with the Directive the subsidiaries are effectively exempt from withholding taxes on dividends and taxes on profit distributions in case of making payments to the parent companies. This option was misused sometimes to minimize taxation.

For example, a Russian or Ukrainian beneficiary may own an operating company in his jurisdiction through the Dutch, Latvian or Luxembourg holding company and an offshore company on top of it. In case of payment of dividends from Luxembourg / Latvia / the Netherlands directly to offshore such dividends shall be subject to a withholding tax at the rate of 15%. To reduce the tax burden, some consultants recommended to interpose over the Luxembourg, Dutch or Latvian company a Cyprus, Malta or another holding company in the country, in which the dividends are tax exempt if paid to the offshore. In this case, dividends from Latvia, the Netherlands and Luxembourg to Cyprus would be tax-exempt according to the rules of the Directive on parent and subsidiary companies, and from Cyprus such payments would be tax-exempt in accordance with the local legislation.

In order to prevent such practice, on January 27, 2015 the following changes to the Directive were adopted:

- the above-mentioned tax benefits under the Directive shall not apply if the arrangement is recognized as not genuine;
- the arrangement is presumed not to be genuine if its only purpose is to obtain tax benefits (i.e., there is no other economic feasibility of operations than obtaining tax benefits);
- unreasonableness of the arrangement is identified through a complex study of all the facts and circumstances of its functioning;
- not the whole arrangement may be admitted as not genuine, but only some of its elements (along with application of the negative effects exactly to such elements);
- the Member States may introduce more tough conditions related to payments between subsidiaries and parent companies in their national legislation compared to the Directive.

The EU Member States are obliged to implement the above changes in the Directive not later than 31.12.2015.



This means that starting from 2016 the tax exemptions on dividends paid to Cyprus/Malta in the example above, or to any other similar jurisdiction shall not be granted if the Cyprus company does not perform the real activity and there is no economic justification of its presence in the arrangement. The Directive did not forbid the countries to set their own measures to combat tax evasion. In the Netherlands such measures have started to be effectively applied since 2012, and an example of the arrangement 'the Netherlands-Cyprus' is a bit outdated, but now the European Commission obliged all the EU countries to amend their legislation providing for such measures of prevention of the tax evasion.

Below are the corresponding changes to the Directive:

*"Article 1*

*[...]*

*2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.*

*An arrangement may comprise more than one step or part.*

*3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.*

*4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse."*

*Article 2*

*1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 December 2015 at the latest [...]».*

Several tendencies may be presumed as a result of the above changes.

Firstly, it is unlikely that the taxpayers will massively create genuine activities at every level of the multi-level holdings. Most likely, the structures will be simplified.

Secondly, the taxpayers will be more likely to choose as the main jurisdictions the countries in which there is no withholding tax on payments to non-residents (Cyprus, UK, Malta, Latvia etc.).

Considering the Russian law on CFCs, many Russian taxpayers will put up with the obligation to pay 15% tax, especially since it will be offset against the Russian personal income tax of 13%, and will remove the superstructures over Dutch and Luxembourg holding companies.

For the Ukrainian beneficiaries such dividends shall be subject to personal income tax at the rate of 20%, which also shall not exceed the rate of withholding tax under the payment from the Netherlands, and taking into account the tax paid in the course of the payment will not cause additional taxation in Ukraine.

Thirdly, some countries may abolish the withholding tax on dividends - Luxembourg already does not tax the dividends paid to residents of countries with which there is a tax treaty. It is possible that this tax will be eliminated entirely.



It can also be assumed that if after the implementation of changes to the Directive the tax authorities of the EU determine that the European arrangements of the Ukrainian or Russian beneficiaries are artificial, the additional taxation is possible. In addition, the practice of obtaining preliminary tax rulings may tighten, and the risk of performing transactions without receiving them shall increase.

We will be happy to answer your questions and, if necessary, analyze the appropriate arrangements and the impact of the above changes on them.

**Roustam Vakhitov**

**Partner**

**International Tax Associates B.V.**

*E: [vakhitov@intertaxlaw.nl](mailto:vakhitov@intertaxlaw.nl)*

*Tel: +31640826427*

**Dmitriy Mikhailenko**

**Partner**

**Law Offices of OMP**

*E: [d.mikhailenko@omp.ua](mailto:d.mikhailenko@omp.ua)*

*Tel: +38 (050) 533-75-85*

