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ECOFIN agrees EU Parent-Subsidiary Directive amendment regarding hybrid loan arrangements

On 20 June 2014, the European Union's Council of Economic and Finance (ECOFIN) Ministers reached agreement on amending and updating the EU's Parent –Subsidiary Directive (2011/96/EU; "PSD") on the basis of a proposal of the European Commission issued on 25 November 2013.

The purpose of the PSD is to avoid double taxation on business profits, by exempting dividends and other profit distributions paid by subsidiary companies to their parent companies within the European Union from withholding taxes, and by exempting the parent company from profits tax - or by granting a credit for profits tax - on dividends received. On 25 November 2013, the European Commission proposed to amend the PSD, also in light of the OECD BEPS discussion, on two relevant points: introduction of a general anti-abuse provision and non-applicability of the PSD in the event of hybrid loans.

It was decided by the European Commission, as recommended by ECOFIN, to split the amendment into the two relevant points so both elements can go through the legislative process separately. As a result, the debate on the precise wording of the general anti-abuse provision was delayed to the second half of 2014, while agreement on the amendment in the PSD in the event of hybrid loans has been reached in the ECOFIN meeting of 20 June 2014.

The amendment seeks to close a loophole in the current PSD resulting from differences in the tax treatment of hybrid loans between EU Member States. Hybrid loans are financing arrangements that have characteristics of both debt and equity. The creditor treats the hybrid loan as equity and receives the remuneration exempt from tax under a participation exemption or tax credit mechanism, while the debtor treats the hybrid loan as debt and can deduct the remuneration paid from its taxable

profit. The amendment approved should prevent companies from creating a situation of double non-taxation through the use of these hybrid loans in their intercompany financing arrangements. Therefore, article 4.1(a) of the PSD will be amended in such a manner that the Member State of the receiving company (parent company or its permanent establishment) will be obliged to refrain from taxing the remuneration on the hybrid loan to the extent that such remuneration is not tax deductible by the subsidiary, and will be obliged to tax such remuneration to the extent that such remuneration is tax deductible by the subsidiary.

This part of the amendment has to be adopted in the forthcoming session of the ECOFIN, after finalization of the text. Member States will have until 31 December 2015 to transpose it into national law.