ATAD Public Consultation – Submission by the Tax Justice Network

September 2024

Florencia Lorenzo

Bob Michel

TAX JUSTICE NETWORK

Contents

Introduction 3
ATAD and the Tax Justice Network's CTHI 3
Controlled Foreign Companies 5
Phasing out of transactional (Model B) regimes 5
Tightening the substance carve-out in non-transactional (Model A) regimes 7
Interest limitation rule 10
Improvements to the fixed ratio EBITDA threshold 10
Abolishment of the grandfathering of old loans 12
Limitation on the deduction of intra-group royalty and services payments 14
Adding a new anti-avoidance tool to the ATADs toolbox 14
Defensive measures without blacklisting 16
Design options for deduction limitation rule 18
Conclusions 20
Annex – ATAD Interest Limitation Rule implementation 22
Bibliography 24

Introduction

ATAD and the Tax Justice Network's CTHI

The purpose of the Anti-tax Avoidance Directive (2016/1164) ('ATAD') is to lay down minimum standard measures to address the most common forms of aggressive tax planning and avoidance practices and to ensure a minimum level of protection of country's tax bases.[1] The ATAD does so in five areas: the interest limitation rule, exit taxation, the controlled foreign company rules, they hybrid mismatches rule and the general anti-abuse rule (GAAR).

The ATAD's purpose is very close to the objective that underpins the Tax Justice Network's Corporate Tax Haven Index (CTHI), which is to champion policies that prevent the artificial manipulation of countries' tax bases and the avoiding of taxes by multinationals. The Corporate Tax Haven Index comprises 18 indicators which measure to what extent countries' tax rules are preventing or conducive to act as a tax haven. Under the subset of 'anti-avoidance', four indicators measure countries' anti-avoidance policies. Two of these indicators – 'interest deduction limitation rules' and 'controlled foreign company rules' – also figure in the ATAD. The two remaining indicators – 'deduction limitation of intra-group payments of royalties' and 'deduction limitation of intra-group payment of service fees' are not part of the ATAD but figure in the EU Code of Conduct Group's 'defensive measures' list. Below, we will argue that a harmonized version of these two measures should be included in the ATAD.

In October 2024, the Tax Justice Network will release its renewed Corporate Tax Haven Index. From this update on, the Index will now be updated on a selective and rolling basis, meaning that indicator subsets will be updated in batches.[2] Given that the first batch of indicators to be released include, among others, the anti-avoidance indicators, we seize this opportunity to share some of our conclusions regarding the state of play of some the relevant anti-avoidance rules in the ATAD. These conclusions are based on research of EU countries' domestic legislations

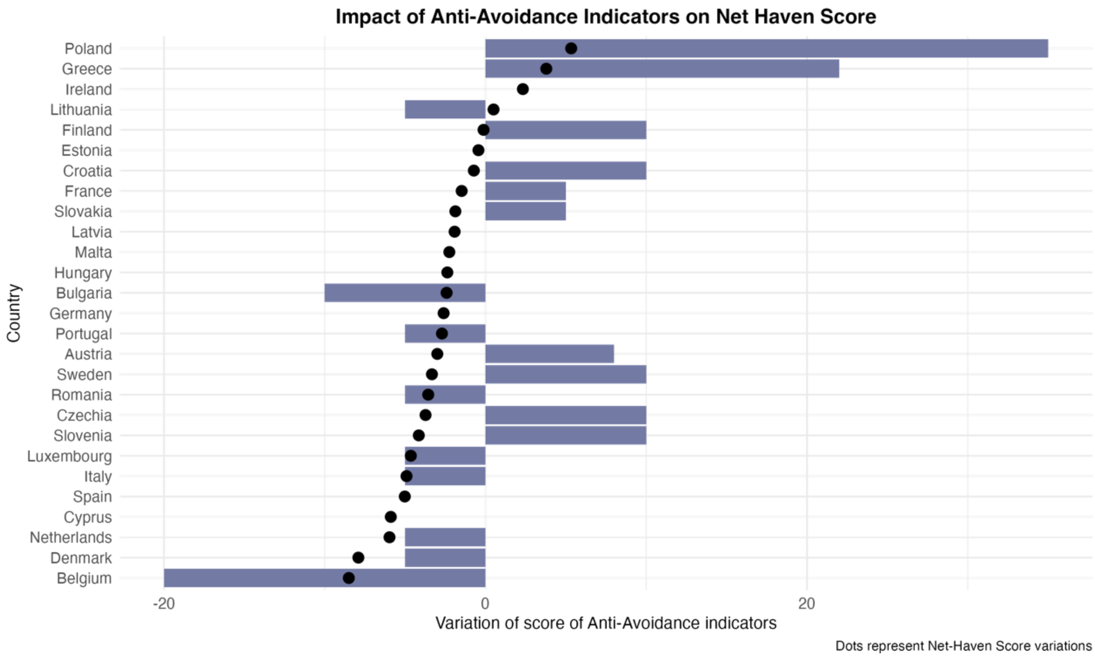
---

[1] EU (2016), *Council Directive (EU) 2016/1164 of 12 July 2016 as amended by Council Directive (EU) 2017/952 of 29 May 2017*, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.193.01.0001.01.ENG&toc=OJ:L:2016:193:TOC.

[2] For more information on the new approach to the Tax Justice Network Indices updates, *see* M. Meinzer and M. Harari, '*Transforming our flagship indexes to be even more responsive and timely*', Tax Justice Network Blog, 13 June 2023, available at: https://taxjustice.net/2023/06/13/transforming-our-flagship-indexes-to-be-even-more-responsive-and-timely/.

as they stood in June 2024 and on our own conception of what we think consist in proper anti-avoidance rules.

The graph below shows the variation of scores of EU countries under the Corporate Tax Haven Index' anti-avoidance indicators in 2024 as compared to 2021. The black dot represents the general score variation over all 18 indicators and not just the anti-avoidance ones. Certain countries drastically improve their score. Belgium, for example, improves its score because it has adopted new CFC rules and switched from Model B (transactional approach) to Model A (non-transactional approach), a change we strongly favour in our scoring. Other countries score less well. Poland, for example, has worsened its score because in 2022 it abolished its limitations on the deductions on the payment of intra-group royalties and services fees.



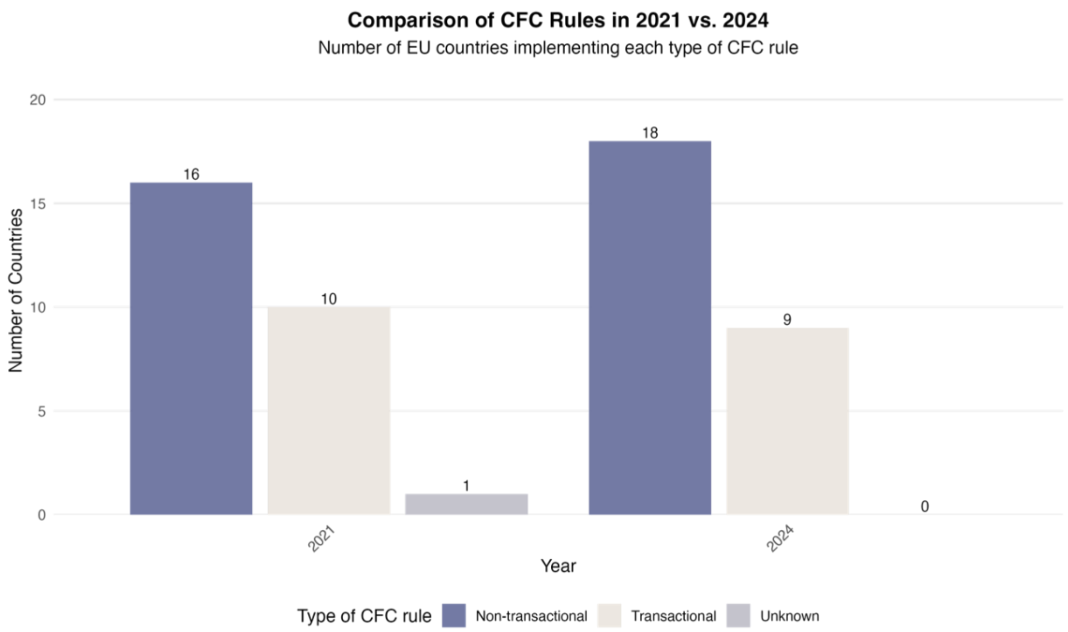
While the full country ranking, underlying data and updated methodology regarding the anti-avoidance indicators of the Corporate Tax Haven Index will be released only in October 2024, we seize this opportunity to submit our findings in relation to the ATAD, and more specifically, in relation to the ATAD's CFC rules and interest limitation regime. We also focus on deduction limitations on intra-group royalties and service fees, which are currently not included in the ATAD but should be. For each of these topics, we make a number of recommendations that should be considered in a revised ATAD and which would serve to make this crucial directive more proficient in realizing its goal, which is to create harmonized and effective anti-avoidance rules in the countries of the EU.

Controlled Foreign Companies

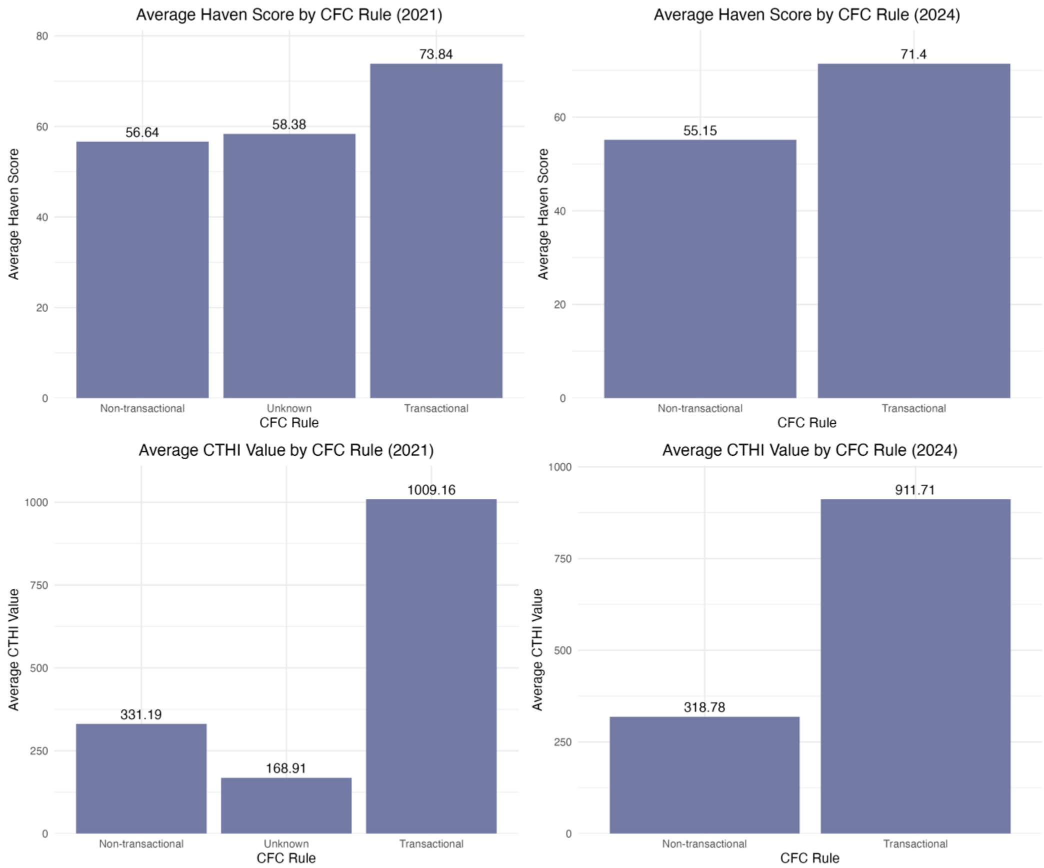
Phasing out of transactional (Model B) regimes

The ATAD requires EU Member Countries to implement one of two options with respect to the inclusion of CFC income in the taxable base. The two options include: (1) Model A – the non-transactional approach which results in an annual inclusion of certain types of (mostly but not limited to passive) income derived by a CFC (article 7(2)(a) of the ATAD); or (2) Model B – the transactional approach which results in an annual inclusion of income that cannot be attributed to the CFC under application of the arm’s-length principle, but is attributable to the EU Member State based in line with assets, functions and risks assumed (article 7(2)(b) of the ATAD.

The Tax Justice Network is of the opinion that the transactional approach of Model B was already implemented in EU countries legislation through its application of the at arm’s-length principle in the context of the pricing of intra-group transactions. Said principle is however ill-placed to serve as an anti-avoidance rule, given the high degree of subjectivity of its application and the in-built reliance on tax authority discretionary powers. Such issues are not faced under the Model A regime of the non-transactional approach. For this reason, the Corporate Tax Haven Index penalizes countries that have adopted Model B of the ATAD whereas a good score is achieved by Model A countries. A growing number of EU Countries agrees with the superiority as an anti-avoidance rule of the non-transactional approach of Model A over Model B’s transactional approach.



Our research furthermore shows that those EU countries that have adopted transactional CFC regimes (Model B) are doing worse on our Corporate Tax Haven Index. On average, Model B countries have a higher 'haven score' than Model A countries, meaning that besides in the case of CFC rule, the former countries are generally more akin to adopt policies that are conducive to tax avoidance and base erosion and profit shifting. If these countries' 'CTHI value' is calculated by weighting the haven score with the countries' share of global cross-border investment, the differences become even more stark.[3] Not only are Model B countries more akin to adopt worse policies, these countries also tend to account for larger shares of those cross-border investments, meaning that the impact of their sub-optimal policy choices has larger quantitative repercussions. As such, Model B countries tend to outrank Model A countries on the Tax Justice Network's Corporate Tax Haven Index.



Model B allows adopting countries to formally comply with anti-avoidance standards while at the same time leaving significant leeway to parent companies to avoid the inclusion of income earned by a CFC. For these reasons, we urge the EU Commission to phase out Model B CFC regimes under the updated ATAD and create a harmonized CFC

[3] For details on the calculation of the quantitative component of the Corporate Tax Haven Index, namely the global scale weight of a country measured in function of its share of cross-border investment, *see* Tax Justice Network (2024), Corporate Tax Haven Index, Version 3.0, October 2024, available from October 2024 at: https://cthi.taxjustice.net/en/.

standard across the EU by requiring all EU countries to convert to a Model A regime.

- **<u>Recommendation 1</u>: phase out the transactional CFC regimes ('Model B') of article 7(2)(b) of the ATAD.**

Tightening the substance carve-out in non-transactional (Model A) regimes

In addition to the phase-out of the Model B regime, the Tax Justice Network urges the EU Commission to revise and tighten the substance carve-out contained in article 7(2)(a), *second sentence*, of the ATAD. The substance carve-out provides that the Model B CFC regime should not apply "*where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.*" While we understand that the inclusion of the substance based carve-out is a reflection of the superiority of primary EU law (*i.e.* the free movement of persons and freedom of establishment) as interpreted by the Court of Justice of the EU, nothing prevents the EU Commission and the EU Parliament from tightening the application of the carve-out for the purpose of further harmonizing its application across EU countries.

Currently, there is no coordinated view on what consists of substantive economic activity. Few countries employ transparent administrative guidelines for the interpretation and application of this pivotal term in the ATADs CFC rules. As a result, tax authorities' discretion prevails for the determination of the scope of the carve-out in practice. This implies, for example, that depending on an individual's EU country's view on the offshoring of corporate ownership, the transfer of a single employee may be sufficient to turn off CFC rules, whereas the same facts and rules would lead to the exact opposite result in a neighbouring EU country.

The problem of the lack of harmonization of the substance carve-out is further compounded by the fact that the ATAD gives countries' the option to refrain from applying the substance carve-out in the case of third country CFCs. Model A countries like Germany, Greece, Poland, Spain and Sweden do not apply the carve-out to third country CFCs, showing that for these countries, the compulsory exception is more a formal prerequisite of ECJ jurisprudence rather than a feat of solid anti-avoidance policy making. Furthermore, certain countries like Denmark are of the opinion that the substance carve-out should also not be applied in the case of purely domestic CFCs. In other words, there is a major divergence across EU countries not only about how the carve-out should be applied if applicable, but also in which situations it can and should be applied. This lack of harmonization of a core component of the

ATADs CFC regime risks undermining all efforts under the Directive to establish harmonized and coherent CFC rules for the Internal Market.

For these reasons, we believe an Updated Directive should remove the substance carve-out. However, if it cannot be removed from the ATAD for reasons mentioned above, we urge the EU Commission to work on a second-best solution which involves the insertion of harmonized thresholds in the ATAD to positively identify whether a CFC is undertaking substantive economic activity without the involvement of tax authority discretion. Only a mechanical application of the substance carve-out can stop the clause from turning into a loophole.

As for the harmonized substance thresholds, inspiration can be found in the Dutch Decree implementing the Dutch CFC law. The Decree spills out a lists of parameters that need to be met before a CFC is deemed to have "*substantive economic activity supported by staff, equipment, assets and premises*":

a) *at least half of the total number of statutory and decision-making board members of the CFC in question reside or are actually established in the state in which the CFC is established;*
b) *the board members of the CFC residing or established in the state have the necessary professional knowledge;*
c) *the CFC has qualified personnel;*
d) *the CFC's management decisions are taken in the state;*
e) *the CFC's main bank accounts are held in the state;*
f) *the CFC's accounting is kept in the state;*
g) *the CFC has a salary cost of at least €100,000;*
h) *the CFC has its own office in the state for a period of at least 24 months.*[4]

These are examples of formal parameters on the use of staff, equipment, assets and premises that could be included in the ATAD to mechanise the application of the substance carve-out. Some of the Dutch parameters may need to be reinforced for the purpose of the ATAD. For example, a salary cost of €100,000 equals a single full time equivalent of staff which is the absolute bear minimum and should be increased if included in the ATAD. It should also be noted that under the

[4] *See* Dutch Corporate Tax Act (1969), at Article 13ab(5), available at: https://wetten.overheid.nl/BWBR0002672/2024-01-01#HoofdstukII_Afdeling2.5_Artikel13ab)l; and Decree Implementing the Corporate Tax Act (1971), at Article 2e, available at: https://wetten.overheid.nl/BWBR0002784/2024-01-01 (accessed 10 September 2024).

Dutch rules, if a CFC does not meet the formal substance requirements, the taxpayer can submit proof based on other elements to show genuine economic activities.[5] This, again, turns the mechanical application of the carve-out into a discretionary application, which should be avoided under a renewed ATAD.

- **Recommendation 2: tighten the substance carve-out in non-transactional regimes ('Model A') in Article 7(2)(a) of the ATAD.**

[5] *See* Dutch Corporate Tax Act (1969), at Article 13ab(11)), available at: https://wetten.overheid.nl/BWBR0002672/2024-01-01#HoofdstukII_Afdeling2.5_Artikel13ab (accessed 10 September 2024).

Interest limitation rule

Improvements to the fixed ratio EBITDA threshold

The ATAD's interest limitation rule is built on the accepted premise that the deductibility of interest payments by companies should not be without limitations. Companies with cross-border operations may use the deductibility of interest to achieve low overall tax burdens by increasing debt levels in group entities located in high-tax countries via intra-group financing.

While the ATAD's interest limitation rule (article 4) does a decent job in transposing the OECD BEPS Action 4 recommendations into EU countries domestic laws, the current rule only provides the bare minimum of protection against debt related base erosion. For this reason, the Tax Justice Network's Corporate Tax Haven Index gives only a medium score to countries which implement the ATADs fixed ratio threshold of deductibility of net borrowing costs to a maximum of 30% of the taxpayer's taxable EBITDA.

There is a lot of room for improvement. First of all, in its 2015 report the OECD recommends a fixed ratio between 10% and 30% of EBITDA, while adding that a higher benchmark fixed ratio (*eg.* 30% of EBITDA) should only be considered if a country applies the fixed ratio in isolation and not in combination with a group ratio rule; does not allow the carry forward or backward of unused interest; or has other rules in place that address based erosion risks associated with intra-group financing.[6]

We note that the ATAD, as it stands, is not in line with the OECD's recommendations. EU Countries are free to adopt lower ratio's than 30% EBIDTA – as is the case in the Netherlands, Finland and Slovakia – yet the prescribed ceiling of 30% does not come with the obligation to refrain from applying the group ratio rule and/or with the compulsory adoption of additional interest limitation rules.

We therefore urge the ATAD to be updated to do better than the current bare minimum limitation rule. This can be achieved either by lowering the ceiling of the fixed ratio to 10% or 20% or by keeping the ceiling rate of 30% but combining this rate with the compulsory elimination of the group ratio rule if a rule above 20% is adopted and with the

---

[6] *See* OECD (2015), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 -*
2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264241176-en, at para 99 (accessed 6 September 2024).

compulsory adoption of additional interest limitation rules. Such additional measure could be the interest limitation rule proposed by the EU Commission in its directive proposal from 2022 for a debt-equity bias reduction allowance (DEBRA). Under Article 6 of the DEBRA proposal, the deductibility of interest would be limited to 85% of excess borrowing costs (*ie.* interest paid minimum interest received).[7] This rule should be inserted in the ATAD to work alongside the fixed ratio deduction limitation. Taxpayers would have to calculate both the deduction amount set by the absolute excess borrowing cost limitation and current fixed ratio limitation. Companies would only be able to deduct the lowest amount in a tax year.[8]

Furthermore, the release of the DEBRA proposal in 2022 illustrates that the EU Commission, by it's own admission, admits that the interest limitation rules in the ATAD (as adopted in 2016) are insufficient to deal with the fiscal risks associated with the tax deduction of interest. Given that the DEBRA proposal will most likely not be adopted, an update of the ATAD is a perfect opportunity to complement the current interest limitation rules.

- **Recommendation 1: lower the general EBITDA threshold and/or make the use the group ratio rule in article 4(5) of the ATAD conditional to an (even) lower EBITDA threshold.**

- **Recommendation 2: complement the fixed ratio interest limitation rule with a DEBRA style absolute threshold for the deduction of excess net interest.**

---

[7] EU (2023), Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, European Commission, 11 May 2022, COM(2022)216, available at: https://taxation-customs.ec.europa.eu/document/download/17a06954-f45c-404c-87e5-4f550cb09030_en?filename=COM_2022_216_1_EN_ACT_part1_v6.pdf (accessed on 6 September 2024).

[8] In the DEBRA proposal, the excess borrowing cost interest deduction limitation is combined with the introduction of an allowance for corporate equity (ACE). In a our public consultation submission on the DEBRA proposal, we explain that, unlike the interest limitation of DEBRA, its ACE component of DEBRA is not fit for purpose and should not be adopted. *See* Tax Justice Network (2023), Bob Michel & Lucas Millán, '*The EU DEBRA proposal An undesirable ACE up the EU Commission's sleeve*', May 2023, available at: https://taxjustice.net/wp-content/uploads/2023/05/The-EU-DEBRA-proposal-An-undesirable-ACE-up-the-EU-Commissions-sleeve-Tax-Justice-Network-May-2023.pdf.

Abolishment of the grandfathering of old loans

In the table in Annex, we provide an overview of the use by individual EU countries of the most important opt-outs under the ATADs interest limitation rule and of the national EBITDA threshold percentages. The most relevant options are (1) the grandfathering of interest on loans agreed before 17 June 2016 (article 4(4)(a)); (2) the group ratio rule (article 4(5)) which allows group companies to apply a group escape clause for the deduction of exceeding borrowing costs based on either an equity/total assets ratio or a group EBITDA test; and (3) the financial exclusion rule (article 4(7)) by which EU countries may exclude financial undertakings from the scope of the general interest limitation rule.

The table shows that the use of the various opt-outs is widespread and that individual country regimes therefore are far from harmonized on certain key aspects. Countries like Latvia, Romania and Sweden are not making use of any of the opt-out possibilities under the Directive and, as such, have implemented a robust and coherent interest limitation regime. On the other hand of the spectrum, countries like Cyprus, Malta and Finland have made use of all opt-outs, thereby implementing a regime that is riddled with loopholes and dilutions. To some extent Finland does a better job than Cyprus and Malta, given that its use of the group ratio option is accompanied with a lower general EBIDTA threshold of 25% and not 30%, as prescribed in the Directive. While this is might be in line with the BEPS Action 4 recommendations, countries committed to strengthening their frameworks should do away with any opt-out possibilities.

The EU Commission's revision of the ATAD is a useful opportunity to assess whether the opt-out possibilities have retained relevancy since the first adoption of the Directive or whether the opt-outs' dramatic impact on the goal of a harmonized interest limitation regime across EU countries requires a change of strategy.

Above, we already suggested that, if retained, the optional group ratio rule should be made conditional to a lower general EBITDA threshold. In addition, we strongly urge for the optional grandfathering of old loans to be abolished. With commercial loans usually having a term that does not exceed 10 years, one would assume that a clause which exempts from the interest limitation regime loans granted before 17 June 2016 would not need a sunset provision to extinguish its effect. As time passes, fewer loans granted before the cut-off date have not yet run their term and the grandfathering clause would therefore die a silent death. Our research shows that these assumptions are wrong. The ATAD's grandfathering clause remains on the radar of EU countries wishing to exploit this loophole. In a Slovenian law adopted in February 2024 to update the country's implementation of the ATAD, the grandfathering clause was expressly enacted in the Slovenian Corporate

Income Tax Act.[9] This shows that the opt-out still has its audience, eight years after the cut-off date. In recent administrative guidance published in Luxembourg, the contours of the loophole are made crystal clear. Subsequent modifications of loans after 17 June 2016 in principle stop the loan from being covered by the grandfathering clause. The guidelines make however clear that loans that undergo modifications which were foreseen before the cut-off date and which do not require agreement of all parties to the loan can continue to benefit from the exemption. The same goes for interest paid on drawdowns (*ie* additional loans) from credit lines granted before the cut-off date up to a maximum amount of credit determined before the cut-off date.[10] In other words, corporate financing tools exist which can be twisted to draw out the effect of the grandfathering clause, turning a temporary exemption into an enduring loophole of the ATAD's interest limitation rule.

For this reason, we urge the EU Commission to delete the grandfathering clause from the ATAD or to add a sunset provision which provides that the clause will be rendered without effect as of 17 June 2026, which seems a reasonable moment to do so, as ten years after the original cut-off date will have passed which is in line with the ordinary 10 year term of commercial loans.

- **Recommendation 3: abolish the grandfathering of loans agreed before 17 June 2026 in article 4(4)(a) of the ATAD.**

[9] *See* EY (2024), *Tax News, February 2024*, Update on Implementation Status of the Three Directives, Dac7, Cesop And Atad, In The Slovenian Legislation, 29 February 2024, available at: https://www.ey.com/en_si/ey-slovenia-tax-alerts/tax-news-february-2024 (accessed on 9 September 2024).

[10] *See* Luxembourg (2022), Circulaire du Directeur des Contributions, Limitation de la déductibilité des intérêts, L.I.R. no. 168*bis*/1, 25 March 2022, at 7.1.1. (Notion de « modification ultérieure » de l'emprunt), available at: https://impotsdirects.public.lu/dam-assets/fr/legislation/legi22/2022-03-25-LIR168bis-1-du-2532022.pdf (accessed 9 September 2024).

Limitation on the deduction of intra-group royalty and services payments

Adding a new anti-avoidance tool to the ATADs toolbox

The purpose of the ATAD is to lay down minimum standard measures on addressing the most common forms of aggressive tax planning and tax avoidance practices. These minimum standards aim to ensure a minimum level of protection for all EU countries' corporate tax bases in a coherent and consistent approach. As the EU Commission describes it: the ATAD sets outs EU measures that should be included in all EU countries tax legislative frameworks.

The anti-avoidance indicators of the Tax Justice Network's Corporate Tax Haven Index are essentially aimed to achieve a similar purpose and largely overlaps with the ATAD's standards. However, two minimum standards are considered in the Index as anti-avoidance 'must-haves' which are not reflected in the ATAD, namely a limitation on the deduction of intragroup royalty payments and a limitation on the deduction of intra-group services payments.

Both deduction limitations are crucial tools to limit base erosion practices, especially because in most instances tax treaties will prevent the taxation of outbound payments in the hands of the recipient. And while the arm's length principle requires that intra-group royalties and service fees should be tax deductible only up to the arm's length price, in many cases the principle does not limit profit shifting. Especially in the case of so-called hard-to-value intangibles, no reliable comparable transactions exist, and the information asymmetries make it so that multinationals are very much in the drivers' seat of determining which group company books taxable profits and which does not. The OECD's guidance issued in 2018 under BEPS Action 8-10 streamlines the pricing approaches to be taken in relation to hard-to-value intangibles, but at the same time the guidance also legitimizes one of the main techniques used in BEPS motivated structuring.[11]

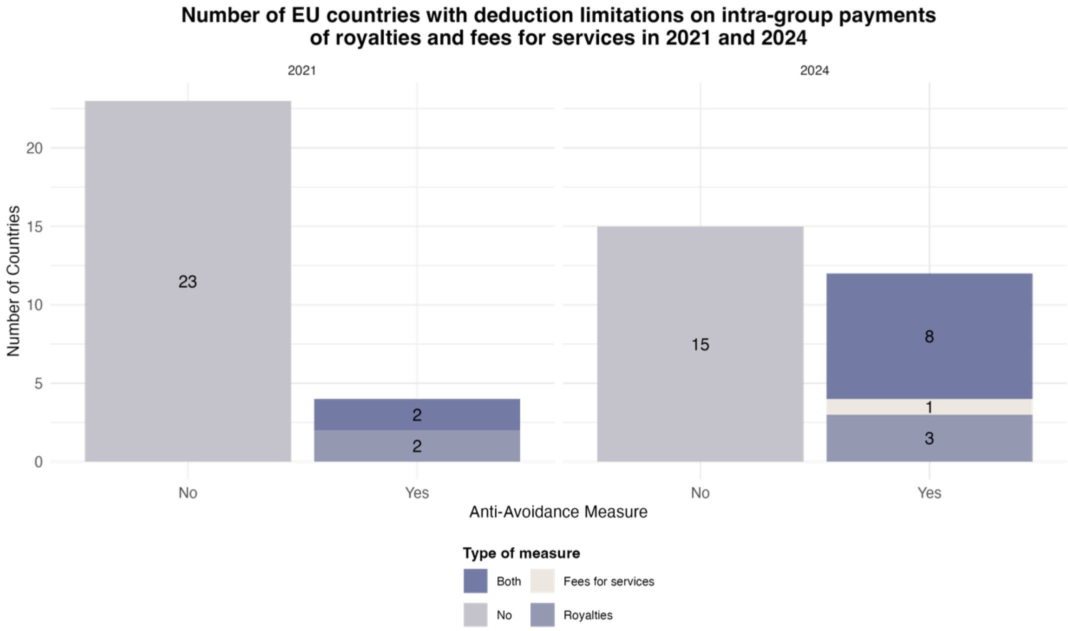
Similar base erosion and profit shifting concerns exist in relation to intra-group services. While not suffering from a lack of comparable

---

[11] *See* BEPS Monitoring Group (2017), *Comments on the Public Discussion Draft: BEPS Action 8 - Implementation Guidance on Hard-to-Value Intangibles*, 22 June 2017, available at: https://www.bepsmonitoringgroup.org/news/2018/5/10/hard-to-value-intangibles.

transactions like in the case of royalties, the ease with which group companies can provide high value managerial, consultancy or technical services in the digitalizes economy, make it so that intra-group services, too, can be the subject of BEPS motived restructuring.

Besides reinforcing the arm's length principle, the OECD has not contemplated any limits to the use intra-group royalty or service fee payments under the auspices of BEPS 1.0. As such, deduction limitation measures have also not made it into the ATAD. Our analysis of country practice between 2021 and 2024 shows however that a large and growing number of EU countries has adopted deduction limitations on intra-group payments for royalties and services.



There is however a large variety and divergence in the national measures that have been adopted. Given that the purpose of the ATAD is to ensure a consistent and coherent approach among EU countries to national anti-avoidance measures, harmonized deduction limitations should figure in an updated version of the ATAD.

In 2023, the EU Code of Conduct Group (which operates under the EU Council's Resolution on a Code of Conduct for Business Taxation) has reviewed and reported on EU countries' recently adopted deduction limitations. The Code of Conduct Group characterizes these types of rules on the 'non-deductibility of costs' as one of four possible 'legislative defensive measures vis-à-vis third country jurisdictions'. The purpose of the Code of Conduct's analysis is to further discussions on whether and how coordination of such measures could be enhanced.[12]

[12] *See* EU (2023), Code of Conduct Group (Business Taxation), *Report to the Council*, 2 June 2023, No. 9875/23, available at:

The only way to enhance coordination of direct tax measures at the EU is to include these into a directive, *ie.* to add harmonized measures on the non-deductibility of cost to the ATAD.

- **Recommendation 1: Include harmonized deduction limitation for intra-group payments of royalties and fees for services in the ATAD**

Defensive measures without blacklisting

As to the harmonized cost limitation rules that should be included in the ATAD, we fundamentally disagree with one crucial aspect of the approach currently adopted by the EU countries with such measures in place and which is also endorsed by the Code of Conduct Group and the EU Council at large. This aspect is the limitation of the scope of cost limitation rules to payments to made to countries figuring on the EU list of non-cooperative jurisdictions (the 'tax haven blacklist'). For a number of reasons, we think this approach is both ineffective and inappropriate.

First of all, countries' contribution to corporate tax havenry and financial secrecy should be assessed in light of a spectrum of nefarious policy options rather than a binary distinction between tax havens and others. One of the principal accomplishments of the Tax Justice Network's Corporate Tax Haven Index and Financial Secrecy Index is to establish, based on verifiable and empirical data, that such a spectrum approach combined with a measure of countries' individual share of global cross-border investment, reveals a rather different geography of corporate tax havens than the traditional picture painted by the EU of tax havens as small (mostly island) states located in the Global South.[13] The continued qualification of Panama as a non-cooperative jurisdiction on the EU tax haven blacklist illustrates this problem. While Panama may be considered a tax haven in one of the three criteria used for blacklisting by the EU Code of Conduct Group, a more refined spectrum analysis reveals that Panama is outranked by 11 EU countries in the most recent edition of the Corporate Tax Haven Index. If only the score attributed to the rules in place are considered without this score being weighted in function of countries' individual share in global financial services, Panama is outranked by 4 EU countries, namely the Netherlands,

---

https://data.consilium.europa.eu/doc/document/ST-9875-2023-INIT/en/pdf (accessed 5 September 2024).

[13] *See* A. Cobham, P. Janský, and M. Meinzer, 'The Financial Secrecy Index: Shedding New Light on the Geography of Secrecy', *Center for Global Development – Working Paper 404,* May 2025, available at: https://www.cgdev.org/sites/default/files/CGD-Working-Paper-Cobham-Jansky-Meinze-Financial-Secrecy-Index.pdf. (accessed 6 September 2024).

Ireland, Malta and Cyprus.[14] Panama could as well include these four countries on a list of non-cooperative EU countries.

Second, the criteria used for EU blacklisting purposes are often far removed from the policy purposes for which the list is used. Panama, once again, serves as a good example. In February 2024, the EU Council confirmed Panama's inclusion in the list because it is only 'partially compliant' with the Global Forum's standard for exchange of information on request and because the country has not given up its harmful foreign source income exemption regime. The first element on exchange of information is not exactly relevant for determining the scope of cost deductibility limitations, especially in intra-group transactions. The second element is relevant and also in the Tax Justice Network's Corporate Tax Haven Index, Panama is granted a bad score under the so-called 'Lowest Available Corporate Income Tax' (LACIT) indicator because it employing a territorial system of taxation and therefore not sufficiently taxing income received by local companies from abroad. However, under the LACIT indicator, the Netherlands obtains a similar score as Panama because, as confirmed in recent research, the country has not completely closed the possibility to obtain low effective tax rates on royalty payments via informal capital constructions that involve the intra-group transfers of intangibles.

Thirdly, the use of blacklists has been widely criticized for singling out smaller countries with weaker economies while frequently excluding powerful countries, including EU member countries, that are key contributors to tax avoidance and base erosion and profit shifting. The listing criteria furthermore lack transparency and legitimacy and the selective approach results in scapegoating smaller, less influential jurisdictions while turning a blind eye to the problems caused by some of the tax policies adopted by EU countries themselves.[15] The blacklist also reinforces racial stereotypes and global inequalities by disproportionately targeting smaller jurisdictions in the Global South.[16] Several of the targeted countries have raised the issues surrounding blacklisting during the 2024 negotiations of the United Nations Framework Convention on International Tax Cooperation, while arguing that blacklists unfairly target them without considering their unique

---

[14] The newly updated Corporate Tax Haven Index will be released in 2024, available at: https://cthi.taxjustice.net/.

[15] Arel-Bundock, Vincent, Loriana Crasnic, Indra Römgens, and Aanor Roland, 'The EU and the Politics of Blacklisting Tax Havens', *URPP Equality of Opportunity Discussion Paper Series*, 27, 2023 <https://www.urpp-equality.uzh.ch/dam/jcr:86003873-1228-461c-8c56-1c8f79486277/27_Arel-bundock_crasnic_romgens_roland_blacklist.pdf> [accessed 11 September 2024]

[16] Dean, Steven A, and Attiya Waris, 'Ten Truths About Tax Havens: Inclusion and the" Liberia" Problem', *Emory LJ*, 70 (2021), 1659

economic and social contexts. Their active involvement in the United Nations process shows that these countries are very much committed to international tax cooperation, even if listed as 'non-cooperative' by the EU. These countries do not have a say in the EU listing process, even though they are heavily affected by it, making this practice a type of international tax policy which lacks all inclusiveness and transparency and which therefore is unbefitting of the EU's international development policy.

The conclusion is that limiting the geographical scope of defensive measures like royalty deduction limitations to countries listed based on an outdated concept of 'tax haven' is both ineffective and inappropriate when EU countries' threat of base erosion by the 'tax haven next door' continues to persist. Generally applying measures are needed, just like in the case of the ATAD's interest deduction limitation rule.

- **Recommendation 2: Include a deduction limitation for intra-group payments of royalties and services fees that applies in relation to all countries and is based on objective threshold criteria**

Design options for deduction limitation rule

As to the design of the generally applying deduction limitation, various options are available:

- One option is to design a cost deduction limitation that disallows deduction if the related income in the hands of the recipient is taxed at a rate less than a certain percentage or less than a certain percentage of the country's tax rate. Germany's 'license barrier rule' and Greece's deduction limitation of interest and services payments (to listed countries) are example of such a regime. Mexico employes a deduction limitation on royalties and services fees in case the payments are taxed at a rate that is less than 75% of the corporate tax rate in Mexico.

- A second option is to include a deduction limitation that limits the amount of intra-group royalty and service fee payments that can be deducted to a percentage of turn-over, taxable income or assets. In the Seychelles, deductions are limited up to a percentage of the turnover of a company. In Ecuador, service fees and royalty payments are deductible up to 20% of the company's taxable base and up to 10% of the value of the company's assets in the pre-operation stage.

- A third option is to partially disallow deduction in function of the tax that can be withheld on the outbound payment. In South Africa, for example, one third of royalty payments can be deducted when the withholding tax rate is at least 10% and one half of royalty payments can be deducted when the withholding tax is 15%.

- A final option is to introduce a deduction limitation in the form of a minimum tax on base eroding services and royalty payments like the United States has done with its 2017 Base Erosion and Anti-Abuse Tax (BEAT). The minimum tax base includes both ordinary profits and added back deductions for cross-border payments for services, interest, rents, and royalties. The purpose is to avoid full erosion of the local tax base by means of service and royalty payments to foreign group companies.

Regardless of the design, for the same reasons as mentioned above in relation to CFC rules, the general deduction limitation should in any case steer clear of being framed as an application of the arm's length principle or including substance carve-outs that rely on full tax authority discretion. Currently, besides limiting the scope to blacklisted countries, nearly all EU countries with defensive cost limitation measures subject the application of this rule to full discretion of the tax authorities. This makes these rules doubly inappropriate.

Conclusions

The ATAD is a crucial piece of legislation in the fight against tax avoidance and the eradicating of base erosion and profit shifting involving EU countries. However, on a number of aspects, the current Directive is underperforming. The EU Commission's 'fitness check' of the ATAD is therefore timely and a good opportunity to evaluate and deal with the existing flaws.

In this report, some of these flaws are discussed and recommendations are made on how to remedy the flaws. With regard to CFC rules, a renewed ATAD should phase out transactional CFC regimes ('Model B'). Non-transactional CFC regimes ('Model A') are superior in achieving their purpose while avoiding discretionary loopholes, and this is also confirmed in recent country practice. However, non-transactional CFC regimes suffer from the lack of a harmonized and discretionary (yet compulsory) substance carve-out. Under a revised ATAD, the substance carve-out should be tightened and its application mechanised by the insertion of clear parameters to identify economic substance. The discretionary application of the current carve-out is not a proportional and transparent measure to further the goal of safeguarding only genuine economic activity.

As to the interest limitation regime of the ATAD, it is clear that the current rules are not respecting international recommendations of good practice.[17] A 30% EBIDTA deduction threshold is only acceptable if it comes with other restrictions, namely the omission of the group ratio rule or the addition of other interest deduction limitations. None of this is currently included in the ATAD. Amendments should be made which either lower the general EBIDTA threshold or make it conditional to other measures. Furthermore, the grandfathering option for old loans should be abolished as practice in certain countries shows that this temporary exemption is turning into a permanent loophole.

Finally, the deduction limitations on intra-group payments of royalties and services fees are important anti-avoidance tools that are used by a growing number of EU countries, as confirmed by the EU Code of Conduct Group. For the purpose of making such measures compulsory across all EU member states while at the same time harmonizing their scopes, these measures should also figure in the ATAD. Unlike what EU countries are currently doing, such deduction limits should not make use of lists of un-cooperative jurisdictions as such practice is both inefficient

[17] Besides the recommendations on this point under BEPS Action 4, *see* also: United Nations (2017), '*Handbook on Selected Issues in Protecting the Tax Base of Developing Countries - Second Edition*', at pp. 15-16, available at: https://www.un.org/esa/ffd/wp-content/uploads/2017/08/handbook-tax-base-second-edition.pdf (accessed 6 September 2024).

and inappropriate. Rather, deduction limitation rules should be devised which rely on objective parameters, like deduction in function of an EBITDA threshold, turnover, taxable income or level of taxation on the side of the recipient.

Annex – ATAD Interest Limitation Rule implementation

	Fixed Ratio Threshold	Grandfathering of Old Loans	Group Ratio Rule Applied	Financial Undertaking Exclusion
Austria	30% of EBITDA	No	Yes	No
Belgium	30% of EBITDA	Yes	No	Yes
Bulgaria	30% of EBITDA	No	No	Yes
Cyprus	30% of EBITDA	Yes	Yes	Yes
Czechia	30% of EBITDA	No	No	Yes
Germany	30% of EBITDA	No	Yes	No
Denmark	30% of EBITDA	No	Yes	Yes
Estonia	30% of EBITDA	No	Yes	Yes
Spain	30% of EBITDA	No	No	Yes
Finland	25% of EBITD	Yes	Yes	Yes
France	30% of EBITDA	No	Yes	No
Greece	30% of EBITDA	No	Yes	Yes
Croatia	30% of EBITDA	No	No	Yes
Hungary	30% of EBITDA	Yes	Yes	Yes
Ireland	30% of EBITDA	Yes	Yes	No
Italy	30% of EBITDA	Yes	No	Yes
Lithuania	30% of EBITDA	No	Yes	Yes
Luxembourg	30% of EBITDA	Yes	Yes	Yes
Latvia	30% of EBITDA	No	No	No
Malta	30% of EBITDA	Yes	Yes	Yes
Netherlands	20% of EBITDA	No	No	No
Poland	30% of EBITDA	No	No	Yes
Portugal	30% of EBITDA	No	Yes	Yes
Romania	30% of EBITDA	No	No	No
Sweden	30% of EBITDA	No	No	No
Slovenia	30% of EBITDA	Yes	No	Yes
Slovakia	25% of EBITDA	No	No	Yes

TOTAL		Yes: 9 EU countries	Yes: 14 EU countries	Yes: 19 EU countries

Bibliography

A. Cobham, P. Janský, and M. Meinzer, 'The Financial Secrecy Index: Shedding New Light on the Geography of Secrecy', Center for Global Development – Working Paper 404, May 2025, available at: https://www.cgdev.org/sites/default/files/CGD-Working-Paper-Cobham-Jansky-Meinze-Financial-Secrecy-Index.pdf. (accessed 6 September 2024).

B. Michel and L. Millán, 'The EU DEBRA proposal - An undesirable ACE up the EU Commission's sleeve', May 2023, available at: https://taxjustice.net/wp-content/uploads/2023/05/The-EU-DEBRA-proposal-An-undesirable-ACE-up-the-EU-Commissions-sleeve-Tax-Justice-Network-May-2023.pdf (accessed on 6 September 2024).

BEPS Monitoring Group (2017), Comments on the Public Discussion Draft: BEPS Action 8 - Implementation Guidance on Hard-to-Value Intangibles, 22 June 2017, available at: https://www.bepsmonitoringgroup.org/news/2018/5/10/hard-to-value-intangibles (accessed on 6 September 2024).

EU (2016), *Council Directive (EU) 2016/1164 of 12 July 2016 as amended by Council Directive (EU) 2017/952 of 29 May 2017*, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.193.01.0001.01.ENG&toc=OJ:L:2016:193:TOC (accessed on 6 September 2024).

EU (2023), Code of Conduct Group (Business Taxation), Report to the Council, 2 June 2023, No. 9875/23, available at: https://data.consilium.europa.eu/doc/document/ST-9875-2023-INIT/en/pdf (accessed 5 September 2024).

EU (2023), Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, European Commission, 11 May 2022, COM(2022)216, available at: https://taxation-customs.ec.europa.eu/document/download/17a06954-f45c-404c-87e5-4f550cb09030_en?filename=COM_2022_216_1_EN_ACT_part1_v6.pdf (accessed on 6 September 2024).

M. Meinzer and M. Harari, '*Transforming our flagship indexes to be even more responsive and timely*', Tax Justice Network Blog, 13 June 2023, available at: https://taxjustice.net/2023/06/13/transforming-our-flagship-indexes-to-be-even-more-responsive-and-timely/.

OECD (2015), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. *http://dx.doi.org/10.1787/9789264241176-en*, at para 99 (accessed 6 September 2024).

S. A, Dean and A. Waris, ‘Ten Truths About Tax Havens: Inclusion and the" Liberia" Problem’, *Emory LJ*, 70 (2021), 1659.

V. Arel-Bundock, L. Crasnic, I. Römgens, and A. Roland, ‘The EU and the Politics of Blacklisting Tax Havens’, *URPP Equality of Opportunity Discussion Paper Series*, 27, 2023 <https://www.urpp-equality.uzh.ch/dam/jcr:86003873-1228-461c-8c56-1c8f79486277/27_Arel-bundock_crasnic_romgens_roland_blacklist.pdf> (accessed 11 September 2024).