ATAD (DIRECTIVE 2016/1164/EU) AND BEPS

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Abstract

In the latest tax competition between the European countries, and not just them (as we will see that this is happening at a global level), made the private companies to chose the best optimization plan for their businesses in all areas so choosing the country that best fitted their needs. This aroused multiple complaints from the countries that had a higher levele of taxation blaming the others and the business men for fiscal crime. As a result of this argument an labeling, there were born two important legislative acts: BEPS and ATAD. In this article I will try to show the connection between this two legislative acts, showing their importance in the intelectual property area and also in the business field. We will se the similarities between them and why this exists and I will explain just a part of the numerous rules established by the international acts BEPS and ATAD. The importance of fiscality and of the businesses, of the multinationals in the context of the globalisation and of the R&D, patents, trademarks, copyrights, all of them are connected and cannot survive without each other in nowadays society, that is why I consider important to present this article and to have together a look into the complicate world of fiscal law.

Keywords: *BEPS, ATAD, tax, fraud, company.*

Introduction

When we talk about the European Union, as we are regarding its legislative acts, we ask ourself in the actual context – which one was the first, BEPS or ATAD? Both legislative acts contain references to the same fiscal aspects, but no are the both applying to all the European Union state members. If we are talking about Romania, for sure we will have the tendency to say that is is ATAD the first, because we are not an OECD member, but our Romanian law no 124/2017 regarding the approval for the Romania participating as an associate state to the BEPS plan - Base erosion and profit shifting – concieved by the The Organisation for Economic Co-operation and Development (OECD). So here we are, applying BEPS legislation!

But what is exactly BEPS? What is ATAD? And mor, why ATAD 1 (Directive (EU) 2015/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market) and ATAD 2 (Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries)?

1. BEPS

Alias BEPS, Base Erosion and Profit Shifting, is a project started by The Organisation for Economic Co-operation and Development – alias OECD – which regards theb state members fiscal planfication in order to stop the tax avoidance strategies that allows the business companies to shift the profits in other countries than those were they are having their activity, countries that have a low level of taxation or even a non-existing one. In few, they are trying to avoid fiscal fraud, but in my opinion, this project was kindly exagerated because it seems like it forgets about the term "fiscal optimisation" and it does make the things even more difficult for the business world, which is already supra-taxed.

How was born the idea of BEPS and why I am presenting it as linked to the intellectual property? This is, probably, a questions already aroused by you. Why fiscality and intelectual property both together and, especially, this two acts that are regarding exclusively fiscality aspects? Well, IP BOX REGIMES. This is the answear.

Starting with the 1970's at an European level a new curent of taxation was born which meant a different taxation of the revenues from the intelectual property than those from other activities. The digitization,the internet conexions, all the tehnlogical advance that made possible the growing and the spread of the music, movies, arts in general, then of the databases and computer's softwares, of all the patents, all this contributed to the intelectual property's amplitude - copyright and industrial property alike. The goal was the encouragement in this ares and as a fact, what else was to do than a smaller taxation?

Irleand was the first country to put in legality the "box regime" fiscal system by Section 34 in the Finances Act from 1973 which stipulated an easier burden, from the fiscality's point of view, for the copyrights and the licenses patented in Ireland. It was a system loved by those who obtained such revenues and hates by the European Community, SAU and G20, a duality which attracted the big companies to establish a small headquarter in Ireland (Google, Facebook, Apple etc.), especially in the IT area, but a system that eventually gave birth to an alignament for the fiscal policies acording to the OECD recommendations named in BEPS – however, late in 2015 (Ireland being the first country which adopted the so-called Knowledge Development Box, a smaller taxation –

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6.25% - for the research and development (R&D) results that were provided by intelectual property activities).

"IP box regime" aroused in amplitude starting with 2000's when it was adopted in many Eurpoean countries, starting with France, 15% and then Hungary 2003 – taxation 8% for the copyrights. Then, in 2014, 14 coutries had their own preferential system for the intangible assets coming from intelectual property activities and R&D: the Neatherlands (hitting 5% taxation in 2010), Spani (15%), Belgium (the taxation with 34% for just 20% of the revenue coming from the intelectual property activities and R&D), Malta (0%), Luxemburg (5.76%), Great Britain (10%), Switzerland (8.5%), the Nidwladen canton (8.8%), Cyprus (2.5%), Liechtenstein (2.5%), Portugal (15%). The wish to stimulate and to atract new investors, but also to collect funds for the state's bugets from a smaller taxation but a large number of companies, "IP box regimes" have become a fiscal optimisation competition.

However, nowadays, there are rumors that the Great Britain is a fiscal pradise from this point of view, and it is hoped thet after the Brexit the country will regain a kinder system for taxation, as Theresa May said "if we are forced to be something different, then we will have to become something different"[1].

The idea of this regim and it's labbeling as bad is directly connected with de globalization phenomena and the existence of more and more multinationals. As an effect, they are connecting countries, but also them are struggling between the legislative differences of each country. Every budget wants to collect more and when other country preffers to collect less, but to be sure it will collect something, the one with a more drastic regim will rebel and will consider this concurential act as a fiscal paradise. "In such conditions, the state, but also the private realised that the finances that they are obtaining and to which they respond need to be managed separately, in different conditions: while the state (compelled to manifest transparently) is interested that the public money to follow a strict rule (to which path can be easily found), the other entities – legal entities and individuals feel the need of a mor relaxed management of funds (...)[2]".

I believe that an alignment towards a kinder taxation will be a response that will give results more than continous watching and the rashly accusation for fiscal fraud or „fiscal paradise". As the fiscal burden is bigger, so more obvious will be it's avoidance. And also we should not forget that there exists the term „fiscal optimisation" which reffers exactly to this thing: the possibility of chosing the most favorable regim. But from the latest trends, if a company does this it is a higer possibility that it will be labelled as a fraud operating in a fiscal paradise.

Channing Flynn, EY Global Technology Industry Leader in the taxation area said once that the multinationals are forced to constantly balance between the intelectual property's oportunities from a country A and the risks of the anti-tax avoidance campains from countries B and C, but the reality is that, in fact, the multinationas just need a permanent establishment from where to conduct it's business[3]. The problem of the moment are the fiscal paradises, or better said, the attempt to eradicate them. So, this is how the idea of BEPS was born, in 15 different actions:

- Action: 1 Address the tax challenges of the digital economy
- Action 2: Neutralise the effects of hybrid mismatch arrangements
- Action 3: Strengthen CFC rules
- Action 4: Limit base erosion via interest deductions and other financial payments
- Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance
- Action 6: Prevent treaty abuse
- Action 7" Prevent the artificial avoidance of PE status
- Actions 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation
  - Action 8 – Intangibles
  - Action 9 – Risks and capital
  - Action 10 – Other high-risk transactions
- Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it
- Action 12: Require taxpayers to disclose their aggressive tax planning arrangements
- Action 13: Re-examine transfer pricing documentation
- Action 14: Make dispute resolution mechanisms more effective
- Action 15: Develop a multilateral instrument.

From all of these, with direct impact for intelectual property are Actions 5 and 8-10, as I will describe them below, but all the plan's actions will apply to each and every company which is activating in the business area.

2. ATAD

As it is revealed in the preamble of the Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, it is necessary to „identify common, yet flexible, solutions at the EU

[1] Adam Bienkov, *Theresa May 'stands ready' to turn Britain into a tax haven after Brexit* (http://uk.businessinsider.com/theresa-may-stands-ready-to-turn-britain-into-a-tax-haven-after-brexit-2017-1).

[2] M.Șt. Minea, C.F. Costaș, *Dreptul finanțelor publice, Vol. I. Drept financiar*, ed. a II-a revizuită, Ed. Universul Juridic, București, 2011, p. 18.

[3] Stephen Bates, Ray Beeman, Ian Beer, Joe Bollard, Andrew Choy, Jim Hunter, *Global taxation of intellectual property: new and emrging tax policies create high-stakes balancing act* (http://www.ey.com/Publication/vwLUAssets/EY-global-taxation-of-intellectual-property-20160518.pdf/$FILE/EY-global-taxation-of-intellectual-property-20160518.pdf)

level consistent with OECD BEPS conclusions" and that the best method for applying it is by european legal instruments – such as directive. The areas in which the directive is applying are: limitations to the deductibility of interest, exit taxation, a general anti-abuse rule, controlled foreign company rules and rules to tackle hybrid mismatches, taking in account also the double taxation. Very important to observe is that the directive is applying also to the resident entities from third parties of the Union if these have a permanent establishment in one or more Member State.

But what is a permanenet estalishment? Aligning to the OECD recommendation, the taxation of the companies is managed to be done at the place where the business is conducted. This is the place where the economical, strategical and necessary decisions for the existing of the business are made or is the place were the executive director is having his activity. In this case, living in the full ares of the technology, where can we say that is this place of the efective conduting when the decisions are made in on-line (teleconferences, for example) or even at the phone, or how do we establish this place when the directors of the company have their departments in different countries? Well, the jurispruence in this ares is very contradictory and does not offers very clear answears. For example, in *Unit Construction Co. Ltd. c. Bullock* (1960) 3 big companies registred in Kenya were considered to be fiscal residents in the country where was registred the parent company, because there were considered to take in place the major decisions. In other case[4], as opposite, there was established that a company registred in Great Britain is fiscal resident in Neatherlands because the management decisions were made at the advice of a consultant living there. In this way, we can see that the place of the efective management is left to interpretations and we do not have imperative stipulations to establish the exact criteria for this terminology.

However, BEPS has an action dedicated to this term of „permananent establishment". This definition is present in all the countries jurisdictions and, especially, in the treaties for the avoidance of double taxation. BEPS suggeested two situations to which will apply this terminology: the first is that of a fixed place in other country, a place where the activity is conducted also in the name of tha parent company, and the second of an dependent agent – meaning a person which is working on another teritory but on behalf of the parent company and who has the ability to sign contracts in the name of the company. Also, it is remembered about the permanent establishment in the Model-Convention of the OECD when it talks about royalty that comes from a contractant state and for which the efective beneficiar is a resident of the other contractant state, this royalties will be taxaed only in that other state. However, this will not be applied if the effective beneficiar of the royalty, being a resident of a contractant state, has activity as an entrepreneur in the other contractant state – from which the royalty comes from – by the means of a permanent establishment situated there and the rights or the property for which are the royalties paid is effective linked to that permanent establishment. In the same direction, Action 5, or the so-called Nexus Approach, proposed by the OECD's members and then developed in BEPS plan, says that the companies should benefit from a preferential fiscal regim only for the substantial activities which generated the revenues in that country where the fiscal burden is smaller. In other words, there should exist a direct link between the revenues and the activity that contributes to it in order to obtain fiscal benefits. However, the actual fiscal regimes will be applied for all the memebers imperatively and progressively until 30 june 2021.

At 29 may 2017 it was decised that „It is necessary to establish rules that neutralise hybrid mismatches in as comprehensive a manner as possible. Considering that Directive (EU) 2016/1164 only covers hybrid mismatches that arise in the interaction between the corporate tax systems of Member States, the ECOFIN Council issued a statement on 12 July 2016 requesting the Commission to put forward by October 2016 a proposal on hybrid mismatches involving third countries in order to provide for rules consistent with and no less effective than the rules recommended by the OECD report on Neutralising the Effects of Hybrid Mismatch Arrangements[5]". In this way was born the Directiva 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries. This defines the "hybrid mismatche" as being an "entity or arrangement that is regarded as a taxable entity under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction". The directive actions should be applied by the state members until first of January 2022, so there exists a derogatory term from the Directive 2016/1164 - 2021.

3. Intangible Assets

When we talk about the intelectual property we are automatically talking about what is called intangible assets. A book, a CD, a invention, this objects just give birth to the rights from which the creative person will aquire legal protection and will benefit from all the economical and non-economical advantages. This rights are a part from the intangible assets and what is called by BEPS Hard To Value Intangibles (HTVI) and to which it dedicates a plain plan – Action 8. „**The business enterprise has two– and only two–basic functions: marketing and innovation**. *Marketing and innovation produce results;*

[4] Wood c. Holden (2008).
[5] Directive (UE) 2017/952 alin. (5) Preamble.

all the rest are costs"[6], how beautiful could caption the essence itself of BEPS and ATAD in the area of intelectual property Peter Druker in this quotation! The world is going to a continuous digitizations, towards an ease of day-by-day life and all of this can be done through R&D, creations, writings and innovation. The intangible capital is formed from assets without material substance, how are in the intelectual property are the patents, the trademarks, the softwares etc. – assets for which there exist rules IAS 38 (International Accounting Standards Board) for evaluating them, because so hard is to establish their value at an international level.To the companies which are activating in this area of business there are applying the stipulations of BEPS and ATAD and because of them this two legislative acts were born. But when it comes to copyrights, even for each individual author, the rules are present, so the royalty that comes from a contractant state and for which the efective beneficiar is a resident of the other contractant state, this royalties will be taxaed only in that other state. However, this will not be applied if the effective beneficiar of the royalty, being a resident of a contractant state, has activity as an entrepreneur in the other contractant state – from which the royalty comes from – by the means of a permanent establishment situated there and the rights or the property for which are the royalties paid is effective linked to that permanent establishment. Also, in the case when because of some special relationships existing between the he who pays and the effective beneficiar or both of them and another third parties, the amount of the royalty regarding to using it, the right or thr information for which is paid, overcomes the amount that was agreed between the payer and the effective beneficiar, and this was not applicable if there was not about that special relationship, than were applicable the rules of the Model-Convention only for the amount mentioned. In this situation, the excendentary part of the payments will remain taxable as the law in every contractany state establish it.

4. BEPS - ACTION 5

Since 2016 there started the tranzition fromthe old fiscal systems regarding the intelectual property to a new system, harmonized, at the level of all the OECD state member for reducing the possibilities of the business companies to avoid tax payement. „Action 5" from BEPS is dedicated especially to this thing and it highlights the importance of transparency, of rewarding just of a few specified substantial activities regarding intangble assets, from the OECD analyze emerging that the base activity that generates revenues as those from R&D, the expenditures should be supported by the entrepreneur itsfel. The new joiners are not allowed to benefit from no preferential regim that exists, starting eith 30 June 2016, for them being mandatory applicable BEPS rules. The new joiners are considered to be the new registred companies after 30 June 2016, but also the ones to whom is applicable the old system until 2021, but for the intelectual property revenues after the date of 30 June 2016, this ones are submissed to the new legislation.

Action 5 is based, especially, on Nexus Approach, a direct connection between the reveues which are submissed to this benefits and the activity that contributes to this revenue and it refers only to the patents and the results of the research and development activities. So, the fiscal benefits are dependent to the expenditure implied in the R&D process.

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

5. BEPS - ACTIONS 8-10

The principle of Arm's lenght is applicable to all the transactions with related parties, shareholders, inclusively for the ones with a foreign legal entity and its permanent establishment from another country. As the Directiva 2016/1164 says, an "associated enterprise" means:

a) an entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25 percent or more or is entitled to receive 25 percent or more of the profits of that entity;
b) an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in a taxpayer of 25 percent or more or is entitled to receive 25 percent or more of the profits of the taxpayer;

If an individual or entity holds directly or indirectly a participation of 25 percent or more in a taxpayer and one or more entities, all the entities concerned, including the taxpayer, shall also be regarded as associated enterprises.

For the purposes of Article 9 and where the mismatch involves a hybrid entity, this definition is modified so that the 25 percent requirement is replaced by a 50 percent requirement[7].

As the Arm's length principle says, the transaction must be made at what the price of that transaction would be on the open market for the same transaction, in other words at the same agreements as the transaction is made between two parties freely and independently of each other, and without some special relationship. If the price is another, and the general tendency for it is to be smaller, then tha level of the taxed amount is affected and the action can be interpreted as tax fraud. As a control method, there was born the transfer pricing documentation, as a plan of BEPS, and which is periodically controled by the fiscal authorities from each member state.

[6] Peter Druker, The Practice of Management, 1954.
[7] Art. 2.4 Directive 2016/1164.

Conclusion

In the end, we are takling about two different legislative acts of the fiscal area, ATAD that was born because of the need for the uniformity and harminy in this ful era of the globalization, esspecially at the business level, from BEPS, a reformal plan sprung from the dissatisfaction of some countries which whished to tax mor the intelectual property, seeing in this field e future economical boom. The general tendency for the countries is to be submissive to this rules and we have the example of Malta which already announced the adopting of the rules sincer 2016.

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