

ATOZ ALERT

The Tax Omnibus Directive: A Trojan Horse for EU tax sovereignty

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On 24 June 2026, the EU Commission adopted a draft directive proposing amendments to six existing EU directives (the "**Tax Omnibus Directive**"). The stated purpose of the amendments is to simplify the EU's framework for direct taxation and support the growth and competitiveness of the EU. However, in its current form, the directive more closely resembles a Trojan horse that would further erode the tax sovereignty of EU Member States.

Introduction

Over the past decade, EU Member States have transposed a cascade of tax directives: Anti-Tax Avoidance Directive ("**ATAD**"), ATAD 2, Directive on Administrative Cooperation (DAC 6 – 9), the Directive on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (the "**Pillar Two Directive**"), and *Faster and Safer Relief of Excess Withholding Taxes Directive* ("**FASTER**"). Each required significant implementation efforts.

In contrast, the Commission has failed to pass ATAD III (the so-called "**Unshell Directive**"), the *Debt-Equity Bias Reduction Allowance Directive* ("**DEBRA**"), the Transfer Pricing Directive, and the *Business in Europe: Framework for Income Taxation Directive* ("**BEFIT**").

Although the EU Commission's previous attempt to pass BEFIT, which would have explicitly harmonised corporate tax bases in Europe, failed, the Commission is now proposing to amend six existing directives. This would strip away all optionality and implement BEFIT's centralising logic without ever calling it BEFIT. This would be BEFIT without BEFIT: harmonisation by stealth.

The question is whether the new draft Tax Omnibus Directive will be adopted unanimously by all EU Member States, or whether it will share the fate of other EU directives that have failed to cross the finish line.

Review of the Tax Omnibus Directive

OVERVIEW

The Tax Omnibus Directive proposes amendments to the following six EU Directives:

- (i) Interest and Royalty Directive (Council Directive 2003/46/EC)
- (ii) Parent-Subsidiary Directive (Council Directive 2011/96/EU)
- (iii) Tax Merger Directive (Council Directive 2009/133/EC)
- (iv) Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164)
- (v) Dispute Resolution Mechanism (Council Directive (EU) 2017/1852)
- (vi) Directive on Faster and Safer Relief of Excess Withholding Taxes – FASTER (Council Directive EU 2025/50)

The most significant changes set out in the Tax Omnibus Directive are as follows:

INTEREST AND ROYALTY DIRECTIVE (“IRD”)

- The Tax Omnibus Directive proposes to remove the minimum holding requirement. Consequently, interest and royalty payments between companies within the Union would be exempt from tax, regardless of their level of participation.
- The proposal states that EU Member States would either have to levy withholding tax or deny the deductibility of interest and royalty payments where the recipient is resident in a jurisdiction that does either not levy corporate income tax or applies a zero tax rate to income from interest and royalties, while the Member State of source does not levy withholding tax either.

PARENT-SUBSIDIARY DIRECTIVE (“PSD”)

- The Tax Omnibus Directive would extend the material scope of the PSD by removing the minimum holding requirement. Consequently, dividends and other profit distributions between companies within the EU would be tax exempt regardless of the shareholding percentage.
- The scope of the PSD would be extended to include pension funds, regardless of their legal form, by way of derogation from the subject-to-tax condition that would otherwise apply.

IRD & PSD

- EU Member States would no longer be able to require prior authorisation to verify that the exemption conditions are met at the time of payment. Instead, taxpayers would self-assess their eligibility, subject to ex post controls and the application of anti-abuse rules, including beneficial ownership rules.

TAX MERGER DIRECTIVE

- The Tax Omnibus Directive proposes to introduce new forms of cross-border reorganisations in the Tax Merger Directive that are not currently covered by the scope of the Tax Merger Directive, specifically the "simplified merger" and the "division by separation". As a result, the scope and definitions of the Tax Merger Directive would be aligned with Directive (EU) 2017/1132 (as amended by the Mobility Directive).

ATAD – INTEREST LIMITATION RULES

- The Tax Omnibus Directive would require EU Member States to allow the deduction of exceeding borrowing costs up to 30% of a company's EBITDA. Member States would no longer be permitted to set a lower threshold. Currently, Member States are free to choose a lower threshold.
- The proposal would exempt loans granted by third parties from the scope of the interest limitation rule, provided that the funds are used to finance the borrowing taxpayer's own activities and are not lent on within the group. The existing interest limitation rules apply equally to loans from both related parties and third parties, with no option to exclude the latter.
- The Tax Omnibus Directive would make the implementation of the safe harbour of EUR 3 million mandatory, which would then be automatically indexed based on annual inflation.

ATAD – CONTROLLED FOREIGN COMPANY (“CFC”) RULES

- The Tax Omnibus Directive would remove the choice between Models A and B that has been provided by ATAD. The Tax Omnibus Directive proposes to make Model A the only possible approach by deleting Model B.

ATAD – HYBRID MISMATCH RULES

- The hybrid mismatch rules include an imported hybrid mismatch rule. This rule applies when a deductible payment made by a taxpayer in an EU jurisdiction (the "importing" jurisdiction) directly or indirectly funds expenses that give rise to a hybrid mismatch outcome (i.e. a deduction without inclusion or a double deduction) between two other jurisdictions (typically non-EU third countries), where the mismatch has not been neutralised by local rules. The Tax Omnibus Directive aims to eliminate this rule.

ATAD – RESEARCH AND DEVELOPMENTS (“R&D”) ALLOWANCE

- The Tax Omnibus Directive proposes the introduction of a new EU-wide R&D allowance as a minimum standard to ensure the deductibility of qualifying R&D expenditure. This allowance would equal the amount of qualifying expenditure and could be deducted from the taxable base.

Critical analysis

CHANGING LEGACY EU DIRECTIVES

Opening comments

The IRD and the PSD were introduced to eliminate barriers for multinational groups operating across several EU Member States. A key achievement for the internal market was the adoption of minimum standards by EU Member States, which removed obstacles to cross-border investment within the EU.

Forcing withholding tax exemptions in an EU context regardless of group affiliation

The Tax Omnibus Directive proposes extending the scope of the IRD and the PSD by removing the minimum holding requirements. The new rules would apply the exemption regardless of the level of participation, thereby extending it to payments between third parties.

This goes far beyond the original intention of the Directives. The IRD and the PSD were designed to eliminate double taxation within groups of companies. The minimum holding requirement was not an arbitrary threshold; it formed part of the definition of what constitutes a group. These Directives were never intended to cover payments between unrelated parties.

By extending the exemption to all payments, regardless of the level of participation, the EU Commission is not addressing double taxation; rather, it is redefining the purpose of these Directives. Even though this broad exemption supports the objectives of the Capital Markets Union, which may be viewed as a positive aspect of the proposal (albeit with the regrettable exclusion of payments to investment funds), this would strip EU Member States of a legitimate source of tax revenue. Accordingly, there is a high likelihood that the proposal will not be adopted in its current form.

Furthermore, the shift to self-assessment could create significant legal uncertainty for taxpayers. Without prior authorisation, taxpayers will bear the risk of incorrect self-assessment, potentially leading to penalties, interest, and prolonged disputes.

Forcing withholding tax or non-deductibility of payments to tax exempt jurisdictions

The Tax Omnibus Directive also provides that EU Member States must either levy withholding tax or deny the deductibility of interest and royalty payments if the recipient is based in a jurisdiction that does not levy corporate income tax, or applies a zero tax rate to income from interest and royalties, while the Member State of source does not levy withholding tax either.

However, punishing entities based in countries that do not levy corporate income tax or apply a zero-tax rate to interest and royalties seems to contradict the EU Commission's previous policy objectives.

THE ATAD/ATAD 2 OVERHAUL

Opening comments

The Tax Omnibus Directive proposes several changes to the Anti-Tax Avoidance Directive (“**ATAD**”) and ATAD 2. Some of these changes would restrict the freedom of EU Member States to adopt stricter tax rules, while others would limit their ability to choose taxpayer-friendly alternatives.

The most significant of these changes are analysed below.

Proposals restricting EU Member States’ taxing rights

The following proposals would restrict the ability of EU Member States to design their tax systems in a way that reflects their national policy choices:

- Interest limitation rules

The Tax Omnibus Directive proposes implementing a mandatory 30% EBITDA threshold up to which borrowing costs should be deductible. Third-party borrowing costs would be excluded from the scope of the interest limitation rules. Furthermore, it is proposed that a mandatory safe harbour of EUR 5 million be implemented (indexed for inflation going forward). These changes would all restrict the flexibility of EU Member States.

However, in general, EU Member States should have maximum freedom to design their own tax systems. Mandating these tax incentives, however, is inappropriate and undermines national sovereignty, regardless of how well-intentioned it may be.

Proposals restricting EU Member States' optionality

The following proposals would limit the flexibility that Member States currently enjoy under ATAD:

- CFC rules

Under the current version of ATAD, Member States can choose between two models for implementing CFC rules:

- Model A targets specific categories of passive income, such as interest, royalties, dividends, leasing, insurance, and invoicing income.
- Model B, by contrast, considers whether the CFC engages in genuine economic activity supported by staff, equipment, assets, and premises. Model B is not a loophole. It is a deliberate choice rooted in the landmark Cadbury Schweppes judgment of the CJEU (C-196/04), which held that CFC rules cannot apply to a subsidiary with genuine economic substance.

The Tax Omnibus Directive proposes eliminating this choice by abolishing Model B, meaning Model A would become mandatory across all Member States. In principle, however, the Cadbury Schweppes judgment and subsequent CJEU decisions mean that Model A should not apply to a subsidiary with genuine economic substance, regardless of the model adopted by EU Member States. Consequently, Model A is causing significant legal uncertainty.

- Hybrid mismatch rules

The proposed elimination of the imported hybrid mismatch rules would be welcome, as this provision has proven particularly challenging for taxpayers and tax administrations.

Overall assessment

The most notable aspect of the Tax Omnibus Directive is its systematic elimination of optionality. By their very nature, directives are instruments that allow for national implementation – they establish minimum standards.

The Commission's approach is now clear. First, it proposes a directive with extensive optionality to reassure EU Member States that their sovereignty will be respected. However, once the directive has been adopted, the Commission returns with a new proposal that eliminates this optionality, claiming that "simplification" requires uniformity.

This could result in a significant erosion of trust, making future tax cooperation even more challenging. This teaches EU Member States that any flexibility granted to them may be temporary.

Summary

The Tax Omnibus Directive is much more than a modest update. Rather, it represents a fundamental reordering of the EU's tax architecture. The IRD and the PSD would be rewritten to extend beyond their original scope. The ATAD's carefully crafted optionality would be systematically eliminated.

Remarkably, the draft Tax Omnibus Directive fails to please anyone. For EU Member States wishing to maintain higher taxation, the Directive restricts their flexibility by imposing mandatory rules that constrain their policy choices. For those Member States that want to

create a business-friendly environment, it eliminates the flexibility that made their approach viable. Everyone would lose out, except the EU Commission.

However, when it comes to tax policy, EU Member States should be free to set their own tax rates, rules, incentives, and approaches to economic development. Tax systems must be tailored to a country's specific economic conditions, political choices, and budgetary needs. The Tax Omnibus Directive undermines this freedom by replacing national discretion with one-size-fits-all mandates.

Finally, the procedural deficit is striking. The call for evidence was open for just 44 days. The impact assessment is vague and the assumptions are questionable. This is not an appropriate way to legislate fundamental tax reform; it's just ticking a box.

What's next?

Ultimately, it seems highly unlikely that the Tax Omnibus Directive, in its current form, will receive unanimous support from all EU Member States, which is necessary for its passage. Sticking with the Trojan Horse metaphor, the Member States have encountered this situation before. They are unlikely to be curious enough to bring it inside again. The Tax Omnibus Directive is unlikely to be adopted. Only time will tell.

Questions?



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