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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. prev. doc.:	9432/16 FISC 84 ECOFIN 499
Subject:	Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market – Political agreement

I. INTRODUCTION

1. The proposal for an Anti-Tax Avoidance Directive (ATAD) was presented by the Commission on 28 January 2016 as part of its Anti-Tax Avoidance Package (ATAP).
2. The ATAD proposal responded to the ECOFIN Council conclusions of 8 December 2015 on Base Erosion and Profit Shifting (BEPS) in the EU context (doc. 15150/15). In these conclusions the ECOFIN Council considered that EU directives should, where appropriate, be the preferred vehicle for implementing OECD BEPS conclusions and invited the Commission to come forward with a legislative proposal on notably OECD BEPS Actions 2, 3 and 4, whilst fully taking into account the work done in the Council in the context of the Common Consolidated Corporate Tax Base (CCCTB) file under previous Presidencies.

3. The ECOFIN Council conclusions also stressed the need to find "*common, yet flexible, solutions at the EU level*" consistent with OECD BEPS conclusions and EU treaty freedoms, and supported an "*effective, swift and coordinated implementation*" by Member States of the anti-BEPS measures to be adopted at the EU level. At the same time, while observing that OECD BEPS conclusions often propose different options, they suggested that a common EU approach in favour of "*certain options*" would "*bring value*" with a view to ensuring the proper functioning of the Single Market.
4. Eight Working Party on Tax Questions (WPTQ) meetings have been held to examine the proposal at technical level. The first two (9 and 17 February 2016) were dedicated to the technical examination of the Commission's original proposal, whilst the last six (4 March, 18 March, 6 April, 15 April, 25 April and 4 May 2016) examined subsequent draft Presidency compromises.
5. The High Level Working Party on Tax Questions (HLWP) examined the outcome of this technical work on 10 May 2016. Some of the delegations raised concerns whether certain provisions in the proposal were technically ready for a decision by ECOFIN and a number of them questioned the need for binding rules on some specific provisions. The HLWP mandated Fiscal Attachés to come up with a final compromise on the remaining issues before Coreper. Fiscal Attachés convened to that effect on 12 and 13 May 2016.
6. The outcome of this work (doc. 8766/16) was discussed in Coreper on 18 May 2016. Delegations raised issues affecting various aspects of the proposal. The Presidency concluded by mandating Fiscal Attachés to discuss open issues.
7. Fiscal Attachés convened to that effect on 19 May 2016, and the Presidency compromise text was subsequently updated (doc. 9060/16) and discussed in Coreper on 24 May 2016, where some delegations reiterated positions taken earlier.

8. The Presidency attempted to reach a general approach at the 25 May 2016 ECOFIN. A new package compromise proposal was distributed (doc. 9520/16), but it was not possible to reach agreement yet. The President of the ECOFIN Council concluded that the open issues that remained to be discussed before a final deal could be reached, are the intra-EU application of CFC rules (Article 8.2.a) and its effective tax rate trigger (Article 8.1.b).
9. The new package compromise proposal distributed at ECOFIN on 25 May has formed the basis for further work. Following the HLWP meeting of 3 June and bilateral contacts with delegations, the Presidency tabled compromise texts on the above, which were discussed by Fiscal Attachés on 13 June 2016. The results of this work are reflected in the updated Presidency compromise (doc. 10039/16). Some delegations, however, raised concerns with regard to the proposed revised CFC carve-out rule for intra-EU situations. Some delegations also requested additional flexibility with regard to the interest limitation rule.
10. The Presidency remains determined to reach a political agreement at the 17 June 2016 ECOFIN, in line with the timetable that was supported by most Member States during the ECOFIN of 12 February 2016 and reiterated during the Informal ECOFIN of 22 April 2016 in Amsterdam. The Directive could subsequently be adopted by the Council. The European Economic and Social Committee (EESC) and the European Parliament have already adopted their own opinions, respectively on 28 April and 8 June 2016.

II. COMPROMISE PACKAGE

11. The Presidency will submit to Ministers a compromise text that contains a package of six concrete provisions for anti-tax avoidance rules:
 - Interest limitation rule;
 - Exit taxation;
 - Switch-over clause;

- General anti-abuse rule;
 - Controlled foreign company (CFC) rule;
 - Hybrid mismatches.
12. With regard to the interest limitation rule (Article 4), it has already been substantially amended compared to the Commission's original proposal allowing for more flexibility and exemptions, while staying consistent with the OECD report on BEPS Action 4. The Presidency therefore only clarified in the text of recital (6) that targeted rules such as thin capitalisation rules can only come *on top of* the 'fixed ratio' approach outlined in Article 4, as is clear from the OECD report. During the Fiscal Attachés meeting of 13 June, several delegations insisted however to be allowed to use targeted rules as a substitute. For the sake of ensuring a level playing field at the international level, some delegations also proposed to suspend the application of Article 4 until agreement in the OECD is reached on a binding minimum standard. Both proposals would raise legal difficulties and were strongly opposed by several other delegations as they argued that all Member States should transpose the general rule from the OECD recommendation (fixed ratio rule), as included in Article 4 of the ATAD proposal, into national legislation by 2019. A few delegations also requested additional flexibility in the grandfathering clause. Overall, the Presidency is convinced that it has reached a fair balance between the different views of Member States and that the compromise text on this Article should now be left unchanged.
13. With regard to the exit taxation rules (Article 5), general anti-abuse rule (Article 7) and hybrid mismatches (Article 10), the Presidency notes that the current texts gather a broad consensus of delegations and that the draft Council statement on hybrid mismatches presented at ECOFIN on 25 May should be an integral part of the political agreement.

14. With regard to the switch-over clause (Article 6): During the ECOFIN meeting of 25 May several delegations suggested to delete this provision. The President of the ECOFIN Council indicated that the switch-over clause contributes to having a coherent package of anti-BEPS measures and he mentioned that deletion should only be considered if a final agreement could be reached on an effective package of the other five provisions.
15. With regard to the CFC rule (Articles 8-9 and recital 13), some important changes were inserted to the Presidency compromise text taking into account Member States' comments at the 25 May ECOFIN and afterwards:
- Tax level trigger (Article 8 paragraph 1(b)): an alternative text, not referring to an effective tax rate threshold, is proposed. It was clarified that this change does not change the effectiveness of the CFC rule and does not prevent Member States that wish so to use at least equivalent fractional thresholds (in relative or absolute terms) when transposing the Directive. On the basis of this clarification, delegations showed openness to accept the proposed change in the spirit of compromise;
 - Carve-out rule for intra-EU situations (Article 8 paragraph 2(a)): several changes were inserted to strike a compromise between the views of the different delegations. On the one hand, the expressions "*commensurate*" and "*which justify the income attributed to it*", which do not appear in the case law, were deleted and the motive test ("*valid commercial reasons*") was removed in order to put the emphasis on the economic activity test. On the other hand, the faculty for the taxpayer to rebut the presumption of CFC ("*the taxpayer can establish that*") was reinserted and the economic activity test was strengthened by the addition of the word "*substantive*". Several delegations expressed concerns with the rebuttable presumption, whilst others wanted the notion of proportionality to be reflected in a clearer way in the legal text. Overall, the Presidency is convinced that it has reached a fair balance between the different views of Member States and that the compromise text on this Article should now also be left unchanged.

16. Against the background of the text adaptations explained above, the draft Council statement in relation to 'controlled foreign companies' and the draft Commission statement in relation to 'effective taxation' that were tabled at ECOFIN on 25 May can be dropped considering that the issues are now covered by the latest changes in the legal text presented above. As indicated above, the third statement on hybrid mismatches remains however an integral part of the compromise package.
17. All delegations broadly welcomed the new proposed Presidency package, though some delegations expressed scrutiny reservations on the latest text adaptations (see above). The Czech Republic also indicated a political reservation on the file.

III. NEXT STEPS

18. In line with the discussion at the Informal Ecofin in Amsterdam on the “ Panama Papers”, the Presidency believes that it is critical to reach a deal now rather than later. Indeed, all Member States have, in the Council conclusions of 8 December 2015 (doc. 15150/15), supported the implementation of the OECD BEPS Action Plan outcomes (October 2015) and a coordinated EU implementation should be preferable to individual national solutions from an Internal Market perspective. The Presidency is also convinced that the technical examination has exhausted both the difficulties and possibilities for additional flexibilities, meaning that further technical examination of the proposal would not add substantial value. In the light of the debate in ECOFIN on 25 May, the Presidency therefore believes that the compromise text on the table is a balanced package for a political agreement.
19. The Permanent Representatives Committee is invited to suggest to the Council:
- to reach a political agreement on the Directive, on the basis of a compromise text set out in doc. 10039/16 FISC 100 ECOFIN 585, with a view to adopting the Directive, subject to legal-linguistic finalisation, as an "A" item on the agenda of a forthcoming Council;
 - to include in the Council minutes the Council statement on hybrid mismatches set out in doc. 10039/16.