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European Union

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OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
On:	17 June 2016
To:	Delegations
No. prev. doc.:	10039/16 FISC 100 ECOFIN 585
Subject:	Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market – Outcome of ECOFIN meeting, 17 June 2016

1. The ECOFIN Council of 17 June 2016 had a discussion with a view to reaching a political agreement on the proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

2. In the light of these discussions the Presidency put forward a final compromise text (as set out in Annex I), with accompanying statements (as set out in Annex II).

3. The Chairman noted that almost all delegations could agree to the Presidency compromise.

4. Against this background the Presidency announced a silence procedure until Monday, 20 June 2016, 24:00 (midnight).

5. If no objections have been raised by that deadline (to be sent to Reijer.Janssen@minbuza.nl, Andreas.Strub@consilium.europa.eu and secretariat.dgg-fisc@consilium.europa.eu), political agreement has been reached and the Presidency will submit this file through the Committee of Permanent Representatives to the Council, for formal adoption as an "A" item (after verification by the lawyer-linguists).

6. After a political agreement has been reached, the Commission is ready to make the following statement:

"The Commission commits to present, before the end of the year, a legislative proposal allowing individual Member States to derogate from the common system of value added tax so as to apply a generalised reverse charge mechanism to domestic supplies above a defined threshold and preserving the Internal Market.".

2016/0011 (CNS)

Proposal for a

COUNCIL DIRECTIVE

laying down rules against tax avoidance practices that directly affect the functioning of the internal market

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 115 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Parliament[1],

Having regard to the opinion of the European Economic and Social Committee[2],

Acting in accordance with a special legislative procedure,

[1] OJ C , , p. .
[2] OJ C , , p. .

Whereas:

(1) The current political priorities in international taxation highlight the need for ensuring that tax is paid where profits and value are generated. It is thus imperative to restore trust in the fairness of tax systems and allow governments to effectively exercise their tax sovereignty. These new political objectives have been translated into concrete action recommendations in the context of the initiative against Base Erosion and Profit Shifting (BEPS) by the Organisation for Economic Cooperation and Development (OECD). The European Council has welcomed this work in its conclusions of 13-14 March and 19-20 December 2013. In response to the need for fairer taxation, the Commission, in its Communication of 17 June 2015 sets out an Action Plan for Fair and Efficient Corporate Taxation in the European Union[3] (the Action Plan).

(2) The final reports on the 15 OECD Action Items against base erosion and profit shifting were released to the public on 5 October 2015. This output was welcomed by the Council in its conclusions of 8 December 2015. The Council conclusions stressed the need to find common, yet flexible, solutions at the EU level consistent with OECD BEPS conclusions. In addition, the conclusions supported an effective and swift coordinated implementation of the anti-BEPS measures at the EU level and considered that EU directives should be, where appropriate, the preferred vehicle for implementing OECD BEPS conclusions at the EU level. It is essential for the good functioning of the internal market that, as a minimum, Member States implement their commitments under BEPS and more broadly, take action to discourage tax avoidance practices and ensure fair and effective taxation in the Union in a sufficiently coherent and coordinated fashion. In a market of highly integrated economies, there is a need for common strategic approaches and coordinated action, to improve the functioning of the internal market and maximise the positive effects of the initiative against BEPS. Furthermore, only a common framework could prevent a fragmentation of the market and put an end to currently existing mismatches and market distortions. Finally, national implementing measures which follow a common line across the Union would provide taxpayers with legal certainty in that those measures would be compatible with Union law.

[3] Communication from the Commission to the European Parliament and the Council on a Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action COM(2015) 302 final of 17 June 2015.

(3) It is necessary to lay down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market. As these rules would have to fit in 28 separate corporate tax systems, they should be limited to general provisions and leave the implementation to Member States as they are better placed to shape the specific elements of those rules in a way that fits best their corporate tax systems. This objective could be achieved by creating a minimum level of protection for national corporate tax systems against tax avoidance practices across the Union. It is therefore necessary to coordinate the responses of Member States in implementing the outputs of the 15 Action Items against base erosion and profit shifting with the aim to improve the effectiveness of the internal market as a whole in tackling tax avoidance practices. It is therefore necessary to set a common minimum level of protection for the internal market in specific fields.

(4) It is necessary to establish rules applicable to all taxpayers that are subject to corporate tax in a Member State. Considering that it would result in the need to cover a broader range of national taxes, it is not desirable to extend the scope of this Directive to types of entities which are not subject to corporate tax in a Member State; that is, in particular, transparent entities. Those rules should also apply to permanent establishments of those corporate taxpayers which may be situated in other Member State(s). Corporate taxpayers may be resident for tax purposes in a Member State or be established under the laws of a Member State. Permanent establishments of entities resident for tax purposes in a third country should also be covered by those rules if they are situated in one or more Member State.

(5) It is necessary to lay down rules against the erosion of tax bases in the internal market and the shifting of profits out of the internal market. Rules in the following areas are necessary in order to contribute to achieving that objective: limitations to the deductibility of interest, exit taxation, a general anti-abuse rule, controlled foreign company rules and rules to tackle hybrid mismatches. Where the application of those rules gives rise to double taxation, taxpayers should receive relief through a deduction for the tax paid in another Member State or third country, as the case may be. Thus, the rules should not only aim to counter tax avoidance practices but also avoid creating other obstacles to the market, such as double taxation.

(6) In an effort to reduce their global tax liability, groups of companies have increasingly engaged in base erosion and profit shifting (BEPS), through excessive interest payments. The interest limitation rule is necessary to discourage such practices by limiting the deductibility of taxpayers’ exceeding borrowing costs. It is therefore necessary to fix a ratio for deductibility which refers to a taxpayer’s taxable earnings before interest, tax, depreciation and amortisation (EBITDA). Member States could decrease this ratio or place time limits or restrict the amount of unrelieved borrowing costs that can be carried forward or back to ensure a higher level of protection. Given that the aim is to lay down minimum standards, it could be possible for Member States to adopt an alternative measure referring to a taxpayer's earnings before interest and tax (EBIT) and fixed in a way that it is equivalent to the EBITDA-based ratio. Member States could in addition to the interest limitation rule provided by this Directive also use targeted rules against intra-group debt financing, in particular thin capitalisation rules. Tax exempt revenues should not be set off against deductible borrowing costs. This is because only taxable income should be taken into account in determining up to how much of interest may be deducted.

(7) Where the taxpayer is part of a group which files statutory consolidated accounts, the indebtedness of the overall group at worldwide level may be considered for the purpose of granting taxpayers entitlement to deduct higher amounts of exceeding borrowing costs. It may also be appropriate to lay down rules for an equity escape provision, where the interest limitation rule does not apply if the company can demonstrate that its equity over total assets ratio is broadly equal to or higher than the equivalent group ratio. The interest limitation rule should apply in relation to a taxpayer's exceeding borrowing costs without distinction of whether the costs originate in debt taken out nationally, cross-border within the Union or with a third country, or whether they originate from third parties, associated enterprises or intra-group. Where a group includes more than one entity in a Member State, the Member State may consider the overall position of all group entities in the same State, including a separate entity taxation system to allow the transfer of profits or interest capacity between entities within a group, when applying rules that limit the deductibility of interest.

(8) To reduce the administrative and compliance burden of the rules without significantly diminishing their tax effect, it may be appropriate to provide for a safe harbour rule so that net interest is always deductible up to a fixed amount, when this leads to a higher deduction than the EBITDA-based ratio. Member States could reduce the fixed monetary threshold in order to ensure a higher level of protection of their domestic tax base. Since base erosion and profit shifting in principle takes place through excessive interest payments among entities which are associated enterprises, it is appropriate and necessary to allow the possible exclusion of standalone entities from the scope of the interest limitation rule given the limited risks of tax avoidance. In order to facilitate the transition to the new interest limitation rule, Member States could provide for a grandfathering clause that would cover existing loans to the extent that their terms are not subsequently modified, i.e. in case of a subsequent modification, the grandfathering would not apply to any increase in the amount or duration of the loan but would be limited to the original terms of the loan. Without prejudice to State aid rules, Member States could also exclude exceeding borrowing costs incurred on third party loans used to fund long-term public infrastructure projects considering that such financing arrangements present little or no base erosion or profit shifting risks. In this context, Member States should properly demonstrate that financing arrangements for public infrastructure projects present special features which justify such treatment vis-à-vis other financing arrangements subject to the restrictive rule.

(9) Although it is generally accepted that financial undertakings, i.e. financial institutions and insurance undertakings, should also be subject to limitations to the deductibility of interest, it is equally acknowledged that these two sectors present special features which call for a more customised approach. As the discussions in this field are not yet sufficiently conclusive in the international and Union context, it is not yet possible to provide specific rules in the financial and insurance sectors and Member States could therefore exclude them from the scope of interest limitation rules.

(10) Exit taxes have the function of ensuring that where a taxpayer moves assets or its tax residence out of the tax jurisdiction of a State, that State taxes the economic value of any capital gain created in its territory even though this gain has not yet been realised at the time of the exit. It is therefore necessary to specify cases in which taxpayers are subject to exit tax rules and taxed on unrealised capital gains which have been built in their transferred assets. It is also helpful to clarify that transfers of assets, including cash, between a parent company and its subsidiaries fall outside the scope of the envisaged rule on exit taxation. In order to compute the amounts, it is critical to fix a market value for the transferred assets at the time of exit of the assets based on the arm's length principle. In order to ensure the compatibility of the rule with the use of the credit method, it is desirable to allow Member States to refer to the moment when the right to tax the transferred assets is lost. The right to tax should be defined at national level. It is also necessary to allow the receiving State to dispute the value of the transferred assets established by the exit State when it does not reflect such a market value. Member States could resort to this effect to existing dispute resolution mechanisms. Within the Union, it is necessary to address the application of exit taxation and illustrate the conditions for being compliant with Union law. In those situations, taxpayers should have the right to either immediately pay the amount of exit tax assessed or defer payment of the amount of tax by paying it in instalments over a certain number of years, possibly together with interest and a guarantee. Member States could request, for this purpose, the taxpayers concerned to include the necessary information in a declaration. Exit tax should not be charged when the transfer of assets is of a temporary nature and the assets are set to revert to the Member State of the transferor, where the transfer takes place in order to meet prudential capital requirements or for the purpose of liquidity management or when it comes to securities' financing transactions or assets posted as collateral.

(11) General anti-abuse rules (GAARs) feature in tax systems to tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions. GAARs have therefore a function aimed to fill in gaps, which should not affect the applicability of specific anti-abuse rules. Within the Union, GAARs should be applied to arrangements that are not genuine; otherwise, the taxpayer should have the right to choose the most tax efficient structure for its commercial affairs. It is furthermore important to ensure that the GAARs apply in domestic situations, within the Union and vis-à-vis third countries in a uniform manner, so that their scope and results of application in domestic and cross-border situations do not differ. Member States should not be prevented from applying penalties where the GAAR is applicable. When evaluating whether an arrangement should be regarded as non-genuine, it could be possible for Member States to consider all valid economic reasons, including financial activities.

(12) Controlled Foreign Company (CFC) rules have the effect of re-attributing the income of a low-taxed controlled subsidiary to its parent company. Then, the parent company becomes taxable to this attributed income in the State where it is resident for tax purposes. Depending on the policy priorities of that State, CFC rules may target an entire low-taxed subsidiary, specific categories of income or be limited to income which has artificially been diverted to the subsidiary. In particular, in order to ensure that CFC rules are a proportionate response to BEPS concerns, it is critical that Member States that limit their CFC rules to income which has been artificially diverted to the subsidiary precisely target situations where most of the decision-making functions which generated diverted income at the level of the controlled subsidiary are carried out in the Member State of the taxpayer. With a view to limiting the administrative burden and compliance costs, it should also be acceptable that those Member States exempt certain entities with low profits or a low profit margin that give rise to lower risks of tax avoidance. Accordingly, it is necessary that the CFC rules extend to the profits of permanent establishments where those profits are not subject to tax or are tax exempt in the Member State of the taxpayer. However, there is no need to tax, under the CFC rules, the profits of permanent establishments which are denied the tax exemption under national rules because these permanent establishments are treated as though they were controlled foreign companies. In order to ensure a higher level of protection, Member States could reduce the control threshold, or employ a higher threshold in comparing the actual corporate tax paid with the corporate tax that would have been charged in the Member State of the taxpayer. Member States could, in transposing CFC rules into their national law, use a sufficiently high tax rate fractional threshold. It is desirable to address situations both in third countries and within the Union. To comply with the fundamental freedoms, the income categories should be combined with a substance carve-out aimed to limit, within the Union, the impact of the rules to cases where the CFC does not carry on a substantive economic activity. It is important that tax administrations and taxpayers cooperate to gather the relevant facts and circumstances to determine whether the carve-out rule is to apply. It should be acceptable that, in transposing CFC rules into their national law, Member States use white, grey or black lists of third countries, which are compiled on the basis of certain criteria set out in this Directive and may include the corporate tax rate level, or use white lists of Member States compiled on that basis.

(13) Hybrid mismatches are the consequence of differences in the legal characterisation of payments (financial instruments) or entities and those differences surface in the interaction between the legal systems of two jurisdictions. The effect of such mismatches is often a double deduction (i.e. deduction in both states) or a deduction of the income in one state without inclusion in the tax base of the other. To neutralise the effects of hybrid mismatch arrangements, it is necessary to lay down rules whereby one of the two jurisdictions in a mismatch should deny the deduction of a payment leading to such an outcome. In this context, it is useful to clarify that measures aimed to tackle hybrid mismatches in this Directive are aimed to tackle mismatch situations attributable to differences in the legal characterisation of a financial instrument or entity and are not intended to affect the general features of the tax system of a Member State. Although Member States have agreed guidance, in the framework of the Group of the Code of Conduct on Business Taxation, on the tax treatment of hybrid entities[4] and hybrid permanent establishments[5] within the Union as well as on the tax treatment of hybrid entities in relations with third countries, it is still necessary to enact binding rules. It is critical that further work is undertaken on hybrid mismatches between Member States and third countries, as well as on other hybrid mismatches such as those involving permanent establishments.

(14) It is necessary to clarify that the implementation of the rules against tax avoidance provided in this Directive should not affect the taxpayers' obligation to comply with the arm's length principle or the Member State's right to adjust a tax liability upwards in accordance with the arm's length principle, where applicable.

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[4] Code of Conduct (Business Taxation) – Report to Council, 16553/14, FISC 225, 11.12.2014.

[5] Code of Conduct (Business Taxation) – Report to Council, 9620/15, FISC 60, 11.6.2015.

(15) The European Data Protection Supervisor was consulted in accordance with Article 28(2) of Regulation (EC) No 45/2001 of the European Parliament and of the Council[6]. The right to protection of personal data according to Article 8 of the EU Charter of fundamental rights as well as Directive 95/46/EC of the European Parliament and of the Council[7] applies to the processing of personal data carried out within the framework of this Directive.

(16) Considering that a key objective of this Directive is to improve the resilience of the internal market as a whole against cross-border tax avoidance practices, this cannot be sufficiently achieved by the Member States acting individually. National corporate tax systems are disparate and independent action by Member States would only replicate the existing fragmentation of the internal market in direct taxation. It would thus allow inefficiencies and distortions to persist in the interaction of distinct national measures. The result would be lack of coordination. Rather, by reason of the fact that much inefficiency in the internal market primarily gives rise to problems of a cross-border nature, remedial measures should be adopted at Union level. It is therefore critical to adopt solutions that function for the internal market as a whole and this can be better achieved at Union level. Thus, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective. By setting a minimum level of protection for the internal market, this Directive only aims to achieve the essential minimum degree of coordination within the Union for the purpose of materialising its objectives.

(17) The Commission should evaluate the implementation of this Directive four years after its entry into force and report to the Council thereon. Member States should communicate to the Commission all information necessary for this evaluation.

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6 Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data (OJ L 8, 12.1.2001, p. 1).

7 Directive 95/46/EC of the European Parliament and the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data (OJ L 281, 23.11.1995, p. 31).

HAS ADOPTED THIS DIRECTIVE:

CHAPTER I
GENERAL PROVISIONS

Article 1

Scope

This Directive applies to all taxpayers that are subject to corporate tax in one or more Member State, including permanent establishments in one or more Member State of entities resident for tax purposes in a third country.

Article 2

Definitions

For the purposes of this Directive, the following definitions apply:

(1) 'borrowing costs' means interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance as defined in national law, including, without being limited to, payments under profit participating loans, imputed interest on instruments such as convertible bonds and zero coupon bonds, amounts under alternative financing arrangements, such as Islamic finance, the finance cost element of finance lease payments, capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest, amounts measured by reference to a funding return under transfer pricing rules where applicable, notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings, certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance, guarantee fees for financing arrangements, arrangement fees and similar costs related to the borrowing of funds;

(2) 'exceeding borrowing costs' means the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law;

(3) 'tax period' means a tax year, calendar year or any other appropriate period for tax purposes;

(4) '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 **<u>9</u>**~~10~~ 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.

(5) 'financial undertaking' means any of the following entities:

(a) a credit institution or an investment firm as defined in point (1) of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council[8] or an alternative investment fund manager (AIFM) as defined in Article 4(1)(b) of Directive 2011/61/EU or an undertaking for collective investment in transferable securities (UCITS) management company as defined in Article 2(i)(b) of Directive 2009/65/EC;

(b) an insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council[9];

(c) a reinsurance undertaking as defined in point (4) of Article 13 of Directive 2009/138/EC;

(d) an institution for occupational retirement provision falling within the scope of Directive 2003/41/EC of the European Parliament and of the Council [10], unless a Member State has chosen not to apply that Directive in whole or in part to that institution in accordance with Article 5 of that Directive or the delegate of an institution for occupational retirement provision as referred to in Article 19(1) of Directive 2003/41/EC;

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[8] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).

[9] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

[10] Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (OJ L 235, 23.9.2003, p. 10).

(e) pension institutions operating pension schemes which are considered to be social security schemes covered by Regulations (EC) No 883/2004 and (EC) No 987/2009 as well as any legal entity set up for the purpose of investment of such schemes;

(f) an alternative investment fund (AIF) managed by an alternative investment fund manager as defined in point (b) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council[11] or an AIF supervised under the applicable national law;

(g) UCITS in the meaning of Article 1(2) of Directive 2009/65/EC of the European Parliament and of the Council[12];

(h) a central counterparty as defined in point (1) of Article 2 of Regulation (EU) No 648/2012[13];

(i) a central securities depository as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council[14].

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11 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1).

12 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

13 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

14 Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1).

(6) 'transfer of assets' means an operation whereby a Member State loses the right to tax the transferred assets, whilst the assets remain under the legal or economic ownership of the same taxpayer;

(7) 'transfer of tax residence' means an operation whereby a taxpayer ceases to be resident for tax purposes in a Member State, whilst acquiring tax residence in another Member State or third country;

(8) 'transfer of a business carried on by a permanent establishment' means an operation whereby a taxpayer ceases to have taxable presence in a Member State whilst acquiring such presence in another Member State or third country without becoming resident for tax purposes in that Member State or third country;

(9) 'hybrid mismatch' means a situation between a taxpayer in one Member State and an associated enterprise in another Member State or a structured arrangement between parties in Member States where the following outcome is attributable to differences in the legal characterisation of a financial instrument or entity:

(a) a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred or the losses are suffered and in another Member State ('double deduction'); or

(b) there is a deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion for tax purposes of the same payment in the other Member State ('deduction without inclusion').

Article 3

Minimum level of protection

This Directive shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases.

CHAPTER II
MEASURES AGAINST TAX AVOIDANCE

Article 4

Interest limitation rule

1. Exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA).

   For the purpose of this Article, Member States may also treat as a taxpayer:

   (a) an entity which is permitted or required to apply the rules on behalf of a group, as defined according to national tax law;

   (b) an entity in a group, as defined according to national tax law, which does not consolidate the results of its members for tax purposes.

   In such circumstances, exceeding borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members.

2. The EBITDA shall be calculated by adding back to the income subject to corporate tax in the Member State of the taxpayer the tax-adjusted amounts for exceeding borrowing costs as well as the tax-adjusted amounts for depreciation and amortisation. Tax exempt income shall be excluded from the EBITDA of a taxpayer.

3. By derogation from paragraph 1, the taxpayer may be given the right:

(a) to deduct exceeding borrowing costs up to EUR 3 000 000;

(b) to fully deduct exceeding borrowing costs if the taxpayer is a standalone entity.

For the purposes of the second subparagraph of paragraph 1, the amount of EUR 3 000 000 shall be considered for the entire group.

For the purposes of point (b) of the first subparagraph, a standalone entity means a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment.

4. Member States may exclude from the scope of paragraph 1 exceeding borrowing costs incurred on:

(a) loans which were concluded before 17 June 2016, but the exclusion shall not extend to any subsequent modification of such loans;

(b) loans used to fund a long-term public infrastructure project where the project operator, borrowing costs, assets and income are all in the European Union.

For the purposes of point (b), a long-term public infrastructure project means a project to provide, upgrade, operate and/or maintain a large-scale asset that is considered in the general public interest by a Member State.

Where point (b) applies, any income arising from a long-term public infrastructure project shall be excluded from the EBITDA of the taxpayer, and any excluded exceeding borrowing cost shall not be included in the exceeding borrowing costs of the group vis-à-vis third parties referred to in point (b) of paragraph 5.

5. Where the taxpayer is a member of a consolidated group for financial accounting purposes, the taxpayer may be given the right to either:

(a) fully deduct its exceeding borrowing costs if it can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group and subject to the following conditions:

(i) the ratio of the taxpayer's equity over its total assets is considered to be equal to the equivalent ratio of the group if the ratio of the taxpayer's equity over its total assets is lower by up to 2 percentage points; and

(ii) all assets and liabilities are valued using the same method as in the consolidated financial statements referred to in paragraph 8;

or

(b) deduct exceeding borrowing costs at an amount in excess of what it would be entitled to deduct under paragraph 1. This higher limit to the deductibility of exceeding borrowing costs shall refer to the consolidated group for financial accounting purposes in which the taxpayer is a member and be calculated in two steps:

(i) First, the group ratio is determined by dividing the exceeding borrowing costs of the group vis-à-vis third-parties over the EBITDA of the group; and

(ii) Second, the group ratio is multiplied by the EBITDA of the taxpayer calculated pursuant to paragraph 2.

6. The Member State of the taxpayer may provide for rules either:

(a) to carry forward, without time limitation, exceeding borrowing costs which cannot be deducted in the current tax period under paragraphs 1 to 5; or

(b) to carry forward, without time limitation, and back, for a maximum of 3 years, exceeding borrowing costs which cannot be deducted in the current tax period under paragraphs 1 to 5; or

(c) to carry forward, without time limitation, exceeding borrowing costs and, for a maximum of 5 years, unused interest capacity, which cannot be deducted in the current tax period under paragraphs 1 to 5.

7. Member States may exclude financial undertakings from the scope of paragraphs 1 to 6, including where such financial undertakings are part of a consolidated group for financial accounting purposes.

8. For the purpose of this Article, the consolidated group for financial accounting purposes consists of all entities which are fully included in consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State. The taxpayer may be given the right to use consolidated financial statements prepared under other accounting standards.

Article 5

Exit taxation

1. A taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets, at the time of exit of the assets, less their value for tax purposes, in any of the following circumstances:

(a) a taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country in so far as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer;

(b) a taxpayer transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or in a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer;

(c) a taxpayer transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a permanent establishment in the first Member State;

(d) a taxpayer transfers the business carried on by its permanent establishment from a Member State to another Member State or to a third country in so far as the Member State of the permanent establishment no longer has the right to tax the transferred assets due to the transfer.

2. A taxpayer shall be given the right to defer the payment of an exit tax referred to in paragraph 1, by paying it in instalments over 5 years, in any of the following circumstances:

(a) a taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third country that is party to the European Economic Area Agreement (EEA Agreement);

(b) a taxpayer transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or a third country that is party to the EEA Agreement;

(c) a taxpayer transfers its tax residence to another Member State or to a third country that is party to the EEA Agreement;

(d) a taxpayer transfers the business carried on by its permanent establishment to another Member State or a third country that is party to the EEA Agreement.

This paragraph shall apply to third countries that are party to the EEA Agreement if they have concluded an agreement with the Member State of the taxpayer or with the European Union on the mutual assistance for the recovery of tax claims, equivalent to the mutual assistance provided for in Directive 2010/24/EU.

3. If a taxpayer defers the payment in accordance with paragraph 2, interest may be charged in accordance with the legislation of the Member State of the taxpayer or of the permanent establishment, as the case may be.

If there is a demonstrable and actual risk of non-recovery, taxpayers may also be required to provide a guarantee as a condition for deferring the payment in accordance with paragraph 2.

The second subparagraph shall not apply where the legislation in the Member State of the taxpayer or of the permanent establishment provides for the possibility of recovery of the tax debt through another taxpayer which is member of the same group and is resident for tax purposes in that Member State.

4. Where paragraph 2 applies, the deferral of payment shall be immediately discontinued and the tax debt becomes recoverable in the following cases:

(a) the transferred assets or the business carried on by the permanent establishment of the taxpayer are sold or otherwise disposed of;

(b) the transferred assets are subsequently transferred to a third country;

(c) the taxpayer's tax residence or the business carried on by its permanent establishment is subsequently transferred to a third country;

(d) the taxpayer goes bankrupt or is wound up;

(e) the taxpayer fails to honour its obligations in relation to the instalments and does not correct its situation over a reasonable period of time, which shall not exceed 12 months.

Subparagraphs (b) and (c) shall not apply to third countries that are party to the EEA Agreement if they have concluded an agreement with the Member State of the taxpayer or with the European Union on the mutual assistance for the recovery of tax claims, equivalent to the mutual assistance provided for in Directive 2010/24/EU.

5. Where the transfer of assets, tax residence or the business carried on by a permanent establishment is to another Member State, that Member State shall accept the value established by the Member State of the taxpayer or of the permanent establishment as the starting value of the assets for tax purposes, unless this does not reflect the market value.

6. For the purposes of paragraphs 1 to 5, 'market value' is the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction.

7. Provided that the assets are set to revert to the Member State of the transferor within a period of 12 months, this Article shall not apply to asset transfers related to the financing of securities, assets posted as collateral or where the asset transfer takes place in order to meet prudential capital requirements or for the purpose of liquidity management.

Article 6

General anti-abuse rule

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

Article 7

Controlled foreign company rule

1. The Member State of a taxpayer shall treat an entity, or a permanent establishment of which the profits are not subject to tax or are exempt from tax in that Member State, as a controlled foreign company where the following conditions are met:

   (a) in the case of an entity, the taxpayer by itself, or together with its associated enterprises holds a direct or indirect participation of more than 50 percent of the voting rights, or owns directly or indirectly more than 50 percent of capital or is entitled to receive more than 50 percent of the profits of that entity; and

(b) the actual corporate tax paid on its profits by the entity or permanent establishment is lower than the difference between the corporate tax that would have been charged on the entity or permanent establishment under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profits by the entity or permanent establishment.

For the purposes of point (b) of the first subparagraph, the permanent establishment of a controlled foreign company that is not subject to tax or is exempt from tax in the jurisdiction of the controlled foreign company shall not be taken into account. Furthermore the corporate tax that would have been charged in the Member State of the taxpayer means as computed according to the rules of the Member State of the taxpayer.

2. Where an entity or permanent establishment is treated as a controlled foreign company under paragraph 1, the Member State of the taxpayer shall include in the tax base:

(a) the non-distributed income of the entity or the income of the permanent establishment which is derived from the following categories:

(i) interest or any other income generated by financial assets;

(ii) royalties or any other income generated from intellectual property;

(iii) dividends and income from the disposal of shares;

(iv) income from financial leasing;

(v) income from insurance, banking and other financial activities;

(vi) income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little economic value;

Point (a) shall 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.

Where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the second subparagraph of point (a).

or

(b) the non-distributed income of the entity or permanent establishment arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

For the purposes of point (b), an arrangement or a series thereof shall be regarded as non-genuine to the extent that the entity or permanent establishment would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.

3. Where, under the rules of a Member State, the tax base of a taxpayer is calculated according to point (a) of paragraph 2, the Member State may opt not to treat an entity or permanent establishment as a controlled foreign company under paragraph 1 if one third or less of the income accruing to the entity or permanent establishment falls within the categories under point (a) of paragraph 2.

Where, under the rules of a Member State, the tax base of a taxpayer is calculated according to point (a) of paragraph 2, the Member State may opt not to treat financial undertakings as controlled foreign companies if one third or less of the entity's income from the categories under point (a) of paragraph 2 comes from transactions with the taxpayer or its associated enterprises.

4. Member States may exclude from the scope of point (b) of paragraph 2 an entity or permanent establishment:

(a) with accounting profits of no more than EUR 750 000, and non-trading income of no more than EUR 75 000; or
(b) of which the accounting profits amount to no more than 10 percent of its operating costs for the tax period.

For the purpose of point (b), the operating costs may not include the cost of goods sold outside the country where the entity is resident, or the permanent establishment is situated, for tax purposes and payments to associated enterprises.

Article 8

Computation of controlled foreign company income

1. Where point (a) of Article 7 paragraph 2 applies, the income to be included in the tax base of the taxpayer shall be calculated in accordance with the rules of the corporate tax law of the Member State where the taxpayer is resident for tax purposes or situated. Losses of the entity or permanent establishment shall not be included in the tax base but may be carried forward, according to national law, and taken into account in subsequent tax periods.

2. Where point (b) of Article 7 paragraph 2 applies, the income to be included in the tax base of the taxpayer shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company. The attribution of controlled foreign company income shall be calculated in accordance with the arm's length principle.

3. The income to be included in the tax base shall be calculated in proportion to the taxpayer's participation in the entity as defined in point (a) in paragraph 1 of Article 7.

4. The income shall be included in the tax period of the taxpayer in which the tax year of the entity ends.

5. Where the entity distributes profits to the taxpayer, and those distributed profits are included in the taxable income of the taxpayer, the amounts of income previously included in the tax base pursuant to Article 7 shall be deducted from the tax base when calculating the amount of tax due on the distributed profits, in order to ensure there is no double taxation.

6. Where the taxpayer disposes of its participation in the entity or of the business carried out by the permanent establishment, and any part of the proceeds from the disposal previously has been included in the tax base pursuant to Article 7, that amount shall be deducted from the tax base when calculating the amount of tax due on those proceeds, in order to ensure there is no double taxation.

7. The Member State of the taxpayer shall allow a deduction of the tax paid by the entity or permanent establishment from the tax liability of the taxpayer in its state of tax residence or location. The deduction shall be calculated in accordance with national law.

Article 9

Hybrid mismatches

1. To the extent that a hybrid mismatch results in a double deduction, the deduction shall be given only in the Member State where such payment has its source.

2. To the extent that a hybrid mismatch results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment.

CHAPTER III
FINAL PROVISIONS

Article 10

Review

1. The Commission shall evaluate the implementation of this Directive, in particular the impact of Article 4, four years after its entry into force and report to the Council thereon. The report by the Commission shall, if appropriate, be accompanied by a legislative proposal.

2. Member States shall communicate to the Commission all information necessary for evaluating the implementation of this Directive.

3. Member States referred to in paragraph 6 of Article 11 shall communicate to the Commission before 1 July 2017 all information necessary for evaluating the effectiveness of the national targeted rules for preventing base erosion and profit shifting risks.

Article 11

Transposition

1. Member States shall adopt and publish, by 31 December 2018 at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions.

   They shall apply those provisions from 1 January 2019.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

3. Where this Directive mentions a monetary amount in euros (EUR), Member States whose currency is not the euro may opt to calculate the corresponding value in the national currency on the date of adoption of this Directive.

4. By way of derogation from Article 5(2), Estonia may, for as long as it does not tax undistributed profits, consider a transfer of assets in monetary or non-monetary form, including cash, from a permanent establishment situated in Estonia to a head office or another permanent establishment in another Member State or in a third country that is a party to the EEA Agreement as profit distribution and charge income tax, without giving taxpayers the right to defer the payment of such tax.

5. By way of derogation from paragraph 1, Member States shall adopt and publish, by 31 December 2019 at the latest, the laws, regulations and administrative provisions necessary to comply with Article 5. They shall forthwith communicate to the Commission the text of those provisions.

They shall apply those provisions from 1 January 2020.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

6. By way of derogation from Article 4, Member States which have national targeted rules for preventing base erosion and profit shifting risks at the date of the entry into force of this Directive, which are equally effective to the interest limitation rule set out in this Directive, may apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard with regard to BEPS Action 4, but at the latest until 1 January 2024.

Article 12

Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Article 13

Addressees

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

ANNEX II

(Draft) Council statement on hybrid mismatches

to be included in the Council minutes

"The Council requests the Commission to put forward a proposal by October 2016 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 BEPS report on Action 2, with a view to reaching agreement by the end of 2016."

(Draft) Statement of the Council and the Commission

in relation to ensuring a level playing field at international level

to be included in the Council minutes

"The objective of the Directive is to ensure a coordinated and coherent implementation at EU level of the OECD's recommendations regarding base erosion and profit shifting (BEPS), which would enhance the single market by introducing a harmonized minimum standard. However, by transposing the OECD's recommendations into a legally binding instrument the EU goes further than the OECD approach. In order to avoid any unintended consequences and ensure that the EU is not placed at a competitive disadvantage relative to its trading partners, the Member States and the Commission will closely monitor the implementation of the BEPS recommendations at global level. The Member States and the Commission should actively engage with the OECD to promote swift, effective and inclusive implementation of BEPS recommendations in order to ensure a level playing field at international level."