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REPORT

From:	Code of Conduct Group (Business Taxation)
To:	Council
Subject:	Code of Conduct (Business Taxation) - Report to the Council

INTRODUCTION

1. On 1 December 1997, the Council and the Representatives of the Governments of the Member States, meeting within the Council, adopted a Resolution on a Code of Conduct for business taxation. This Resolution provides for the establishment of a Group within the framework of the Council to assess tax measures that may fall within the Code. In its report to the Feira European Council on 19 and 20 June 2000, the ECOFIN Council agreed that work should be pursued with a view to reaching agreement on the tax package as a whole, according to a parallel timetable for the key parts of the tax package (taxation of savings, Code of Conduct (business taxation) and interest and royalties).

2. On 9 March 1998, the Council confirmed the establishment of the Code of Conduct Group. The Group reports regularly on the measures assessed and these reports are forwarded to the Council for deliberation.

3. This report from the Code Group encompasses the work of the Code Group in 2014 under the Italian Presidency.

4. In accordance with the Procedural Aspects of the Group (16410/08 FISC 174), the Group should maintain to aim at a (broad) consensus to reflect the positions of the Member States in the Group in its reports to ECOFIN, to avoid losing the effectiveness of the Group, while respecting the principle of unanimity as laid down in the Council conclusions of 9 March 1998 concerning the establishment of the Code Group. In the case broad consensus cannot be reached, the Group's reports can express the various views mentioned.

PROGRESS OF WORK

5. The Code of Conduct Group met on 16 September, 22 October and 20 November 2014 under the Italian Presidency.

6. At the meeting of 16 September 2014 the Group confirmed a programme of work under the Italian Presidency, agreeing to take forward work in the following areas:

(a) continue its work on rollback;
(b) continue existing work on standstill;
(c) continue work on the various aspects of the Group's Work Package 2011.

APPOINTMENT OF VICE CHAIRS

7. Mr. Pierluigi Sorrentino (Italy) and Mr. Andrejs Birums (Latvia) were confirmed as respectively the first and the second Vice-Chairs for the period up to the end of the Italian Presidency.

STANDSTILL

8. Member States have made commitments not to introduce new tax measures that would be harmful within the meaning of the Code. The Group's work programme for the Hellenic Presidency identified the following measures where further discussion under standstill was required:

- *Patent boxes*

9. In December 2013 ECOFIN invited the Group to analyse the third criterion of the Code of Conduct by the end of June 2014 and to assess all patent boxes in the EU, including those already assessed by the end of the year, taking into account international developments, including those in relation to the OECD BEPS initiative.

10. Therefore, in co-ordination with developments at the OECD, the Group considered two approaches to identifying harmful aspects of patent boxes under criterion 3 in more detail. These were the transfer pricing approach and the modified nexus approach.

11. Following the request of some delegations, the Group has also examined, with the assistance of the Council Legal Service, the compatibility of the modified nexus approach with EU law and especially with the freedom of establishment and the freedom to provide services. It was then considered that, although it could be said that the modified nexus approach did not treat comparable situations in a discriminatory manner, this of course did not preclude the possibility of a particular national measure being found incompatible with the Treaty freedoms in the future because of a restriction to the right of companies to choose where they carry out their R&D activities. This would depend on the legal and factual context of the case.

12. Following all discussions in the OECD Forum on Harmful Tax Practices, a compromise regarding the modified nexus approach was endorsed by the Group (see Annex 1). The Group agreed that the EU patent box regimes that had been subject to examination by the Group are not compatible with the modified nexus approach as adapted by the compromise. As a consequence, these EU patent boxes should therefore be changed in line with the compromise. The Group agreed that the legislative process necessary to give effect to that change and the related monitoring by the Code of Conduct Group should commence in 2015.[1]

ROLLBACK

UK: Gibraltar – Income Tax Act 2010

13. European Commission (DG Competition) opened a formal state aid investigation procedure in order to investigate certain aspects of Gibraltar's Income Tax Act 2010 on 16 October 2013.

14. Spain reiterated the need to examine other aspects of the Gibraltar tax regime not covered by the state aid procedure and provided the Group with information on other potentially harmful parts of the Gibraltar tax regime. At the meeting on 18 March 2014, the Commission circulated a paper presenting the information provided by Spain and the UK's comments on it. Aspects identified included inbound profit transfers and 'shell companies'.

15. With regard to inbound profit transfers the Group agreed to consider Gibraltar's compliance in conjunction with other Member States and their associated territories.

[1] The Netherlands has a reservation on the scope of IP assets qualifying for tax benefits under an IP-regime. For the Netherlands it is important that these IP regimes are not limited to patents, but could also cover other innovations derived from R&D (not being trademarks and marketing), provided that such activities have been certified by a competent government authority (not being the tax authorities), so that the linkage between R&D, IP-assets and profits (tracking and tracing) can be ensured.

16. As regards shell companies UK and Gibraltar provided additional information at the meeting on 22 October. The Group's view is that the treatment of shell companies established by individuals to hold their assets falls within the Code. Further information will be provided in view of subsequent discussions between the UK, Spain and the European Commission on the tax treatment of these companies.

WORK PACKAGE

17. The Group continued its work on the Work Package 2011 under the Italian Presidency.

Anti-Abuse – Mismatches

18. Technical work on Mismatches was continued in a Code of Conduct Sub-Group, which met on 29 September (afternoon) and 13 November (morning) 2014. At the meeting on 20 November 2014 the Italian presidency presented a report on the work of the Sub-Group, where the focus was on mismatch situations of hybrid entities and hybrid permanent establishments in the EU. The Group agreed the guidance and explanatory notes on intra-EU hybrid entities as set out in Annexes 2 and 3. Further work is required to the draft guidance on hybrid permanent establishments.

Monitoring the implementation of agreed guidance on Inbound Profit Transfers

19. In the meeting on 22 October Commission presented a check list which may form the basis for assessing the extent to which MS rules comply with the agreed guidance on inbound profit transfers. Member States were invited to send their comments on the check list. The work on the check list will continue during the Latvian Presidency. The Group will then consider the anti-abuse measures of all Member States after the presentation of the Commission analysis based on the tool box approach.

Preparation of guidance or application notes

20. The preparation of guidance and application notes requires further work which shall be carried out after the outcome of the Group's considerations on the patent boxes.

Links to third countries

Switzerland:

21. The dialogue on company tax issues between Switzerland and the European Commission has been successfully concluded. A Joint Statement was signed in October 2014. In the Meeting on 22 October the Group was updated on recent developments in Swiss corporate tax policy.

Liechtenstein

22. At the meeting on 16 September Commission noted that it had had only limited discussions with Liechtenstein in the past. Thus, it was agreed that Commission would prepare a paper dealing with possible harmful measures in Liechtenstein's tax legislation. The Group decided to ask the Commission to continue the dialogue with Liechtenstein on the basis set out in the paper.

ANNEX 1

Compromise on Modified Nexus Approach for IP regimes

A) The Modified Nexus Approach – conceptual issues

1. Nexus Approach: General acceptance of the Modified Nexus Approach as presented in the OECD Report on Action 5, but requiring further modifications relating to the level of qualifying expenditure, grandfathering provisions and the tracking and tracing of expenditure:

2. Up-lift: Under the currently proposed Modified Nexus Approach, businesses using already existing Patent Box regimes might see a reduction in income receiving preferential treatment, as R&D expenditure to develop the patent must be undertaken in a more limited number of entities, including the company holding the relevant patent, to qualify. This could impose restructuring costs on groups which have dedicated R&D companies in order for them to retain the relief in future. Furthermore, to disregard any IP acquisition costs at all might have an impact on commercial decisions. To reflect these concerns raised by businesses, Member States may allow for an up-lift of qualifying expenditure within the Modified Nexus Approach. However, one needs to take into account that the very conceptual basis of the Modified Nexus Approach is intended to ensure that, in order for a significant proportion of IP income to qualify for benefits, a significant proportion of the actual R&D activities must have been undertaken by the qualifying taxpayer itself. Accordingly, such up-lift needs to be restricted. It may only be granted to the extent that expenditure in the context of outsourcing and acquisitions has actually taken place, and it is in any case limited to a certain percentage of the qualifying expenses of the respective company: **30%**. This percentage-based limitation relates to the overall amount of both outsourcing and acquisition costs. For the avoidance of doubt, acquisition costs and expenditures for outsourcing to related parties are not included in qualifying expenditures, but are taken into account in determining the limitation described in the preceding

Example (1):
Parent company incurred qualified expenses of 100,
parent company incurred costs for **acquisition of IP** assets of 10,
subsidiary company incurred R&D expenses of 40.
⇨ Maximum up-lift amount = 100 x 30 % = 30

⇨ Overall qualifying expenses including a limited percentage of outsourcing and acquisition costs = 130

Example (2):
Parent company incurred qualified expenses of 100,
parent company incurred costs for **acquisition of IP** assets of 5,
subsidiary company incurred R&D expenses of 20.
⇨ Maximum up-lift amount = 100 x 30 % = 30

⇨ Overall qualifying expenses including a limited percentage of outsourcing and acquisition costs = 125

B) Timing, grandfathering and reporting issues

1. Close old regime to new entrants: Member States choosing to have IP regimes will need to bring the applicable rules in line with the Modified Nexus Approach. That means that there can be no new entrants to any existing regime after the date that a new regime consistent with the modified nexus approach takes effect, and no later than 30 June 2016. Any legislative process necessary to make this change must commence in 2015. This transition period for the closure of existing regimes to new entrants recognises that Member States will need time for any legislative process.

"New entrants" include both new taxpayers not previously benefiting from the regime and new IP assets owned by taxpayers already benefiting from the regime. Further, it is understood that new entrants are only those that fully meet all substantive requirements of the regime and have been officially approved by the tax administration, if required. New entrants therefore do not include taxpayers that have only applied for the regime.

2. Final abolition of old regime: In order to give protection for taxpayers benefiting from existing regimes, Member States are allowed to introduce grandfathering rules. Under such rules, all taxpayers benefiting from an existing regime may keep such entitlement until a second specific date ("abolition date"). The period between the two dates should not exceed 5 years (so the abolition date would be **30 June 2021**). After that date, no more benefits stemming from the respective old regimes may be given to taxpayers.

3. Further work to be concluded by June 2015.

a) Reporting requirements under Modified Nexus Approach: An approach to the tracking and tracing of R&D expenditure, that is practical for tax authorities and companies to implement, needs to be developed in order to implement the Modified Nexus Approach. Agreement will also be needed on transitional provisions to enable companies to transfer IP from existing regimes into new regimes. The Code of Conduct Group acknowledges that it might be difficult for companies to provide detailed information about qualifying expenditure for past years under the Modified Nexus Approach if – until the time at which new rules are introduced – there is no requirement for them to track such expenditure. Practical methodologies for identifying qualifying expenditure that companies and tax authorities should use recognising the particular issues regarding qualifying expenditure with respect to expenses incurred prior to the introduction of the Modified Nexus Approach will be agreed. Failure to do so will mean that no tax benefit may be granted to those companies under the Modified Nexus Approach. Special rules will be developed for this time period to ease the tracking and tracing of such expenditure.

b) Additional safeguards: The Code of Conduct Group will discuss measures to mitigate the risks that new entrants seek to avail themselves of existing regimes with a view to benefiting from grandfathering. Examples could include enhanced transparency (e.g., requiring spontaneous exchange of information on taxpayers benefiting from a grandfathered regime regardless of whether a ruling is provided), monitoring of new entrants, and possible restrictions, so as to mitigate the risk of new entrants availing themselves of existing regimes with a view to benefiting from grandfathering.

ANNEX 2

Guidance on Hybrid Entity Mismatches Concerning Two Member States

1. For the purposes of this Guidance, which applies to the extent that a mismatch situation concerns two Member States

   1.1. an entity is treated as *transparent* for tax purposes

      1.1.1. where it is not a taxable entity and it is treated wholly or partly as *look-through*, in the sense that income derived, and expenditure incurred, by or through the entity are treated, for tax purposes, as income and expenditure of the holders of equity interests in the entity, in proportion to their respective interests, or

      1.1.2. where it is *disregarded* as a separate entity, in the sense of being treated for tax purposes as a part or branch of the entity that owns it;

   1.2. a *hybrid entity* is an entity that is treated for tax purposes as being transparent by one Member State and as not being transparent by another Member State;

   1.3. a *mismatch situation* for two Member States, in relation to a hybrid entity, is where the mismatched treatments of that entity by the two Member States, as being transparent and as not being transparent, are relevant to the treatment for tax purposes of a transaction involving the entity;

   1.4. a *double deduction* arises where a deduction or other tax relief is given in each of two Member States for the same payment, expense or loss made or incurred by a hybrid entity, insofar as that payment, expense or loss is deducted from or relieved against income that is not received by the hybrid entity;

   1.5. a *deduction without inclusion* arises in respect of so much of a payment or expense for which a deduction or other tax relief is given by a Member State but for which there is not a corresponding receipt recognized for tax purposes by any Member State or other State.

2. Where as a result of a mismatch situation for two Member States, in relation to a hybrid entity

   2.1. a double deduction would otherwise arise, then, for the purpose of preventing that double deduction, the two Member States concerned should treat that entity as not being transparent, or

   2.2. a deduction without inclusion would otherwise arise, then, for the purpose of preventing that deduction without inclusion, the two Member States concerned should treat that entity as being transparent,

notwithstanding the treatment of that entity that would otherwise apply.

3. A hybrid entity should be treated as being transparent or not being transparent, in accordance with this guidance and contrary to the treatment that would otherwise apply, only to the extent that is necessary for the purpose of preventing a double deduction or deduction without inclusion that would otherwise arise, and not for any other purpose.

4. To assist the implementation of this guidance by Member States, each Member State should prepare, and update as necessary, for compilation and publication by the Commission, a list of entities, taking into account the work done in this respect by the OECD

   4.1. that can be formed or created under its laws, and

   4.2. which it treats as transparent for tax purposes.

ANNEX 3

Explanatory notes on the guidance on Hybrid Entity Mismatches Concerning Two Member States

These notes are arranged in the order of the relevant paragraphs of the text of draft guidance.

- ***General comment on format of the draft text***

Paragraph 1 and its six subparagraphs set out the meaning of certain terms for the purposes of the guidance. *Paragraph 2* does the main work of the guidance - specifying an alignment of treatments of hybrid entities where mismatched treatments would otherwise result in a double deduction or deduction without inclusion. *Paragraph 3* ensures that this alignment cannot be used to achieve unintended results: it is solely to prevent the double deduction or deduction without inclusion. *Paragraph 4* would assist the implementation of the guidance by providing for the gathering together of relevant information from Member States in relation to their treatment of entities.

- ***Paragraph 1 - introductory line***

> **1. For the purposes of this Guidance, which applies to the extent that a mismatch situation concerns two Member States**

These introductory words serve three purposes:

They signal that the meanings of terms set out in the paragraph are for the purposes of the guidance only and are not intended to have any wider significance.

They limit the application of the guidance, in addressing mismatched treatments, to situations that are relevant to the tax treatment of a transaction in Member States.

- o The text refers to *two* Member States to be clear that each of the mismatched treatments of the hybrid entity – as transparent or non-transparent - is by a Member State. If an aggressive tax planning arrangement involved more than one mismatch the guidance would apply to each mismatch separately.

- o A triangular situation in which the entity is located in a third State (EU or non-EU) but where the mismatched treatments are by two Member States would also be covered. The purpose of the text is to exclude a situation where one of the mismatched treatments is by a non-EU State.

The introductory words are also intended to address situations where the hybrid entity is partly owned in a Member State and partly owned in a non-EU State[2]. In such circumstances the guidance will only apply *to the extent that* the results of the mismatch are relevant to the Member State concerned.

[2] As the guidance is concerned with *intra-EU* mismatches, the other party to the transaction would be located in a Member State.

- ***Paragraph 1.1***

1.1 an entity is treated as transparent for tax purposes

1.1.1 where it is not a taxable entity and it is treated wholly or partly as look-through, in the sense that income derived, and expenditure incurred, by or through the entity are treated, for tax purposes, as income and expenditure of the holders of equity interests in the entity, in proportion to their respective interests, or

1.1.2 where it is disregarded as a separate entity, in the sense of being treated for tax purposes as a part or branch of the entity that owns it*;*

In order to define *hybrid entity* for the purposes of the guidance, the term *transparent* must first be defined. The meaning of an entity being treated as *transparent* is a cornerstone of the draft guidance.

Although such instances may not be very frequent, the draft guidance explicitly addresses entities that are only *partly* transparent. Where the use of a partly transparent entity would otherwise result in a *double deduction* or *deduction without inclusion*, the draft guidance would prevent the achievement of those results.

The draft guidance focuses on the meaning of transparent rather than the meaning of opaque or non-transparent. Once transparent is defined, the meaning of not being transparent follows without the need for a separate definition: an entity will be treated as not being transparent if (a) it is a taxable entity *or* it is treated neither wholly nor partly as look-through *and* (b) it is not disregarded as a separate entity.

The second subparagraph of the meaning of transparent, which refers to an entity being disregarded as a separate entity, has been included for completeness and is principally relevant to an entity classification option[3] that does not appear to be currently provided by any Member State.

- ***Paragraph 1.2***

1.2. a *hybrid entity* is an entity that is treated for tax purposes as being transparent by one Member State and as not being transparent by another Member State;

The definition above of *hybrid entity* substitutes “Member State” for “State” in the Commission Services’ text, as the definition is being used for guidance in respect of *intra-EU* hybrid entity situations.

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[3] US “check the box” rules allow an election to disregard an entity as separate from its equity holder.

The reference to *national classification rules* was deleted from the definition, as some Member States may not have specific classification rules, designating an entity as transparent or non-transparent.

- ***Paragraph 1.3***

  1.3. a *mismatch situation* for two Member States, in relation to a hybrid entity, is where the mismatched treatments of that entity by the two Member States, as being transparent and as not being transparent, are relevant to the treatment for tax purposes of a transaction involving the entity;

It was agreed that a mismatch of treatments by two Member States was only of interest where each MS concerned had a direct interest in the tax consequences of a transaction involving the entity (being a transaction relevant to the *double deduction* or *deduction without inclusion* referred to in paragraph 2). The term *mismatch situation* is, therefore, defined for the purposes of the guidance and then incorporated into paragraph 2 as a condition for the guidance to apply.

- ***Paragraphs 1.4 and 1.5***

In the draft guidance proposed by the Subgroup, the reference in the Commission Services' text to "harmful effects" has been replaced by references to two specific types of results of mismatch situations, i.e. *double deduction* and *deduction without inclusion*. The proposed hybrid entity guidance would apply to transactions that result in these effects.[4]

The terms *double deduction* and *deduction without inclusion* are given specific meanings to enable these results to be identified objectively.

- o The Subgroup considered whether the proposed guidance should only apply where the transaction involving the hybrid entity is between related parties (with appropriate anti-abuse provisions for back-to-back arrangements). The Subgroup did not favour this approach, considering *inter alia* that it would add complexity and could reduce the effectiveness of the guidance: it is not reflected in the proposed draft guidance.

- o Similarly, the Subgroup did not favour an exception to the proposed guidance for *bona fide* commercial arrangements, as this could introduce an unwelcome subjectivity into the application of the guidance.

- ***Paragraph 1.4***

  1.4 a double deduction arises where a deduction or other tax relief is given in each of two Member States for the same payment, expense or loss made or incurred by a hybrid entity, insofar as that payment, expense or loss is deducted from or relieved against the income that is not received by the hybrid entity;

[4] The proposed guidance would not apply to transactions resulting in other, unspecified, effects: *double deduction* and *deduction without inclusion* were the only categories of double non-taxation, resulting specifically from hybrid entity mismatches, which were identified by the Subgroup.

This defines *double deduction* for the purposes of the guidance. The meaning set out is intended to be sufficiently wide in scope to cover situations where the relief is not given by direct deduction - for example, where the relief is given by tax credit.

The ending of sentence in paragraph 1.4 serves to ensure that for the purpose of the guidance term *double deduction* does not cover cases when expenses are deducted in computing hybrid entity income that is doubly taxed.

Reference to the "*same* payment, expense or loss" should be given its ordinary meaning - for example, where a deduction is given in one Member State under a group relief regime to a company other than the company that actually incurred the payment or expense, that deduction must be in respect of the same payment or expense for which the deduction is given in the other Member State.

- ***Paragraph 1.5***

  1.5 a *deduction without inclusion* arises in respect of so much of a payment or expense for which a deduction or other tax relief is given by a Member State but for which there is not a corresponding receipt recognized for tax purposes by any Member State or other State;

This defines *deduction without inclusion* for the purposes of the guidance. The guidance is concerned with double non-taxation that arises from the *mismatched* treatment of hybrid entities, causing deductible payments in one Member State not to be taken into account, for inclusion as income, by the other or the same Member State. The aim of the guidance, in the context of a *deduction without inclusion*, is to either deny the deduction of the payment in one Member State or to cause the receipt of the payment, which would otherwise disappear or be ignored for tax purposes, to be brought into account by any Member State.

The text makes clear that a part only of a deductible payment may not have been included as a receipt.

- This could happen where a payment through an entity goes to equity holders in different States - *State A* treating the entity as non-transparent, resulting in non-inclusion of its part of the payment, but *State B* treating the entity as transparent, resulting in inclusion of its part of the payment through the entity. This situation will only result in *deduction without inclusion* as respects the part of the payment that has not been included by *State A*.

- This could also happen - a part only of a deductible payment not being included as a receipt - by virtue of the treatment of a hybrid entity as being *partly* transparent by one of the Member States concerned in a mismatch situation.

The text also ensures that a *deduction without inclusion* is not deemed to arise where there is inclusion of the payment concerned in a third EU or non-EU State.

- This will not affect the restriction of the draft Guidance to intra-EU situations only: the deduction without inclusion must result from a “mismatch situation for two Member States” (see *paragraph 2* of the draft Guidance). It would be wrong, nevertheless, to define *deduction without inclusion* as potentially including situations where the payment concerned had, in fact, been included and recognized for tax purposes in a third State - whether EU or non-EU.

- This will also exclude from the meaning of *deduction without inclusion* payments that are brought into account as income for CFC purposes by a third State - whether EU or non-EU.

The description of the non-inclusion of the payment – “*there is not a corresponding receipt recognised for tax purposes”* – is intended to target situations where, due to mismatched treatments of hybrid entities, payments “disappear”, i.e. they are not brought into account as amounts received at all. A deductible payment can be tax-relieved in a cross-border context by reason either of domestic law or of double tax treaty reliefs and exemptions. In such cases, the other Member State is not prevented from taking appropriate measures.

- ***Paragraph 2***

2. Where as a result of a mismatch situation for two Member States, in relation to a hybrid entity

2.1. a double deduction would otherwise arise, then, for the purpose of preventing that double deduction, the two Member States concerned should treat that entity as not being transparent, or

2.2. a deduction without inclusion would otherwise arise, then, for the purpose of preventing that deduction without inclusion, the two Member States concerned should treat that entity as being transparent,

notwithstanding the treatment of that entity that would otherwise apply.

Paragraph 2 contains the text that prevents the mismatched treatment of hybrid entities by Member States from resulting in a *double deduction* or *deduction without inclusion*.

To do so, it draws upon the terms set out in *paragraph 1* to identify the elements that must be present for the guidance to apply, i.e.

- a *mismatch situation* involving two Member States,
- in relation to a *hybrid entity*,
- resulting in a *double deduction,* or *deduction without inclusion.*

Where these elements are present, *paragraph 2* prescribes a fixed alignment of the treatments of the hybrid entity, to prevent the mismatch that results in the *double deduction* or *deduction without inclusion*:

- In the case of *double deduction,* the alignment is for both MS to treat the entity as *not being transparent*.
- In the case of *deduction without inclusion,* the alignment is for both MS to treat the entity as being *transparent*.

This approach, of prescribing fixed alignments, has been adopted as a clear and straightforward approach to anti-mismatch coordination:

- o It provides the clearest basis for the alignment of treatments to eliminate mismatches resulting in *double deductions* and *deductions without inclusion* - the central purpose of the Guidance.

- o It eliminates the need to refer to the treatment in the Member State under the laws of which the entity was *established.*

- o It eliminates any need to refer to *third, i.e. non-EU, States*, which could be a source of some confusion in the context of draft Guidance directed exclusively to *intra-EU mismatches*.

- o It eliminates an administratively problematic scenario that could arise with other approaches. This theoretically possible, but improbable, scenario would involve the treatment of an entity being aligned *from* transparent *to* non-transparent to ensure the inclusion of income in a *deduction without inclusion* mismatch. In such circumstances the entity concerned - to which the income is to be attributed - might not be set up in the tax administration systems of the Member State concerned.

- ***Paragraph 3***

  3. A hybrid entity should be treated as being transparent or not being transparent, in accordance with this guidance and contrary to the treatment that would otherwise apply, only to the extent that is necessary for the purpose of preventing a double deduction or deduction without inclusion that would otherwise arise, and not for any other purpose.

The Subgroup considered the scope for manipulation inherent in an unqualified alignment-based approach to the proposed guidance (e.g. it could create opportunities for loss-trafficking). *Paragraph 3* is intended to prevent any manipulation or abuse of the proposed guidance.

It should also ensure that no more than is necessary is done to prevent hybrid entity mismatches delivering *double deductions* or *deductions without inclusion*.

- *Paragraph 4*

  4. To assist the implementation of this guidance by Member States, each Member State should prepare, and update as necessary, for compilation and publication by the Commission, a list of entities, taking into account the work done in this respect by the OECD

  4.1. that can be formed or created under its laws, and

  4.2. which it treats as transparent for tax purposes.

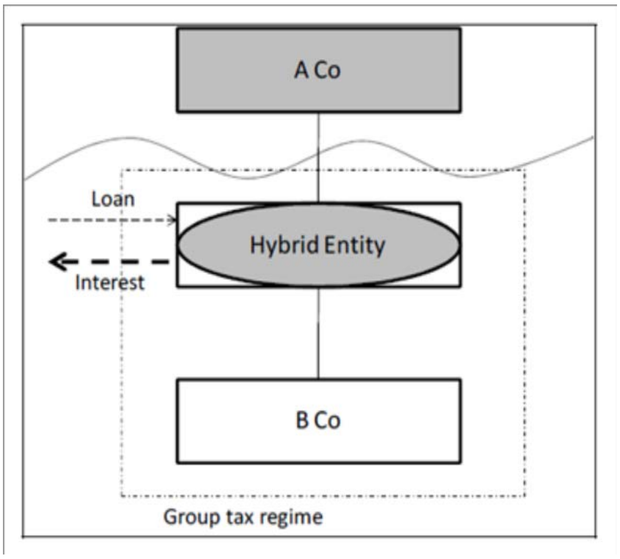
The purpose of the compilation of lists is to assist Member States in determining whether there are mismatched treatments in specific instances.

Each Member State will only be asked to list those entities, treated as transparent by that Member State, which can be established under its own laws.

Although this listing should not be an onerous requirement of each Member State, the collected listings should provide a comprehensive picture of the intra-EU treatment of entities, thereby enabling the identification, by taxpayers and tax administrations, of potential mismatches.

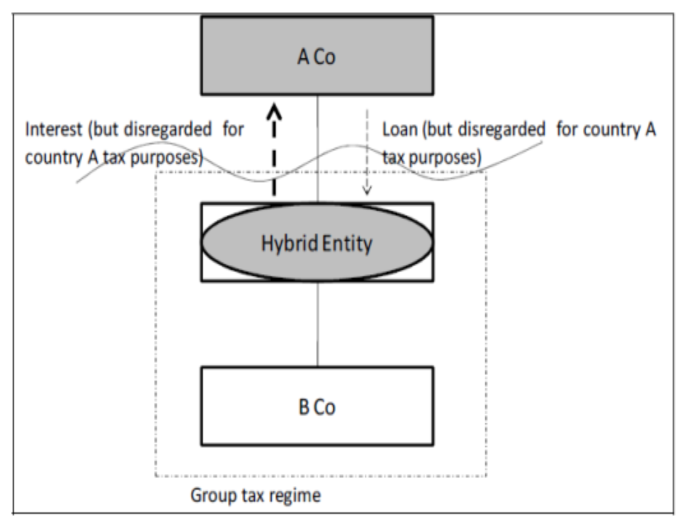
Examples

Example 1



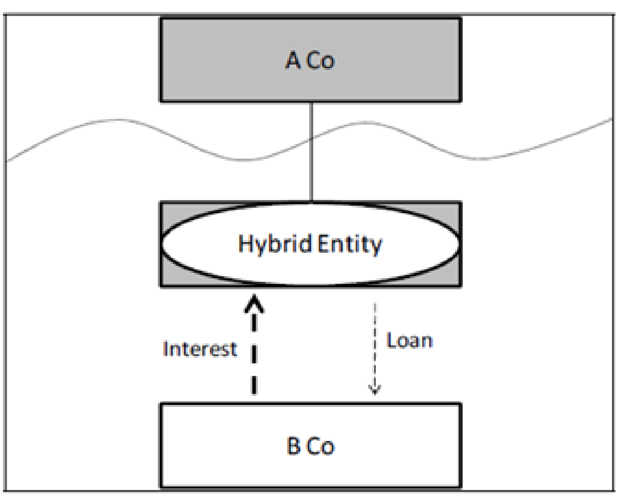
- hybrid entity is
  - transparent for MS A purposes so interest is deductible in MS A
  - non-transparent in MS B so interest is deductible in MS B
- **double deduction** arises
- if *alignment to non-transparent treatment* of hybrid entity in MS A and MS B then:
- MS A would treat Hybrid entity as non-transparent— and the interest would only be deductible in MS B

Example 2



- hybrid entity is
  - transparent for MS A purposes so the loan and interest is disregarded
  - non-transparent in MS B so interest is deductible in MS B
- **deduction without inclusion** arises
- if *alignment to transparent treatment* of hybrid entity in MS A and MS B then:
- the entity, loan and interest would be disregarded and there would be no deduction in MS B

Example 3



- hybrid entity is
  - non-transparent for MS A tax purposes, so the interest arises in a non-resident corporation for MS A purposes
  - transparent in MS B, and no PE in MS B, so interest is deductible in MS B in B Co and is not taxable in MS B
- **deduction without inclusion** arises
- if *alignment to transparent treatment* of hybrid entity in MS A and MS B then:
- receipt of interest would be recognized in MS A