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## **REPORT**

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From:	General Secretariat of the Council
To:	Council
No. prev. doc.:	8899/16 FISC 75 ECOFIN 397
Subject:	Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market – General approach

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### **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 continued to raise issues affecting various aspects of the proposal. The Presidency concluded by mandating Fiscal Attachés to provide further work on three items and to report back to Coreper:
  - Detailed aspects of the grandfathering clause in Article 4(4)(a) (interest limitation rule);
  - Need and possibilities for a longer transition period in Article 12(1) (transposition);
  - Alternative possible compromise solution for the application of Article 8(2)(a) (controlled foreign company rule - CFC) to intra-EU situations.

7. Fiscal Attachés convened to that effect on 19 May 2016, and the Presidency compromise text was subsequently updated on the above-mentioned first two issues as reflected in doc. 9060/16, whilst no changes were made on the third aspect. This updated Presidency compromise text was discussed in Coreper on 24 May 2016, where some delegations reiterated positions taken earlier.
8. The Presidency is determined to reach a general approach at the 25 May 2016 ECOFIN on a legally binding minimum standard for preferably all six anti-BEPS provisions proposed by the Commission, 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 following the adoption of the EP report (consultation) which is expected for 6 June 2016. The European Economic and Social Committee (EESC) has already adopted its own opinion on 27-28 April 2016.

## **II. COMPROMISE PACKAGE**

9. The Presidency takes the view that the compromise text to be submitted to Ministers contains a consistent package of six concrete provisions for anti-tax avoidance rules:
  - Interest limitation rule (Article 4): the aim of this rule, which is based on the conclusions of OECD BEPS Action 4, is to discourage taxpayers from artificially shifting their debt to Member States with more generous deductibility rules;
  - Exit taxation (Article 5): the aim of this rule is to discourage taxpayers from transferring their tax residence and/or assets for mere aggressive tax planning purposes, which is of particular importance in the context of the Internal Market;
  - Switch-over clause (Article 6): this clause would force Member States not to exempt taxpayers from tax on foreign income originating from a low tax third country;
  - General anti-abuse rule (Article 7): this rule is designed to cover any gap that may exist in existing anti-abuse rules;

- Controlled foreign company (CFC) rule (Articles 8-9): the aim of this rule, which is based on the conclusions of OECD BEPS Action 3, is to tax companies resident in low tax jurisdictions when controlled by EU resident taxpayers;
  - Hybrid mismatches (Article 10): the aim of this rule, which is based on the conclusions of OECD BEPS Action 2, is to neutralise the tax effects of hybrid mismatch arrangements, which exploit differences in the tax treatment of an entity or instrument under the laws of two or more Member States to achieve a deduction in both states or a deduction of the income in one state without inclusion in the tax base of the other.
10. The Presidency has noted the reservations of several delegations expressed in Coreper in relation to different aspects of the draft Presidency compromise. Some delegations have a general political reservation against the background of possible negative economic impacts. Others see a difficulty in changing their current national systems (in particular related to the interest limitation rule) or in introducing new rules based on those foreseen in the Directive (in particular related to exit taxation and the CFC rule).
11. In line with the discussion at the Informal Ecofin in Amsterdam on the “ Panama Papers”, the Presidency nevertheless 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.

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. Some delegations still asked for some additional waivers, while other delegations were concerned that more flexibility would harm the effectiveness of the rule. In order to find a final compromise the Presidency has extended the scope of the grandfathering clause, while introducing conditions to prevent loopholes. In the latest compromise proposal the non-modification clause and the cut-off date are refined. 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), the Presidency notes that the remaining reservations are due to the current inexistence of such rules at national level. The Presidency therefore believes that this difficulty can be tackled through a longer period for transposition in Article 12, as proposed in the latest Presidency compromise.
14. With regard to the General anti-abuse rule (Article 7), the Presidency notes that the current text gathers a broad consensus of delegations.
15. With regard to the general architecture of the proposed CFC rule (Articles 8-9), with the choice left to Member States between two approaches, as defined in paragraphs 2a (entity / categorical approach) and 2b (transactional approach), the Presidency is aware that a number of delegations have asked for the deletion of so called approach "2b" but notes that both approaches are expressly allowed by the OECD BEPS Report on Action 3, and remains convinced that the proposed architecture is the only way to gather consensus.

16. With regard to the rules on hybrid mismatches (Article 10), the Presidency is aware that some delegations would have wished to extend the scope of Article 10 to third countries and to other forms of hybrid mismatches, in line with the OECD BEPS report on Action 2. Some possible legal drafting to that effect was examined by the WPTQ on 25 April and 4 May. but several delegations have indicated that they would not be in a position to agree on such extension at this stage in view of the limited time left for technical examination. The Presidency therefore believes that the current provision, which is in line with the scope originally proposed by the Commission, should be left unchanged but supports the critical importance of further work in this area, as outlined in recital (14). To that end the Presidency will table a Council statement requesting the Commission to put forward a proposal on hybrid mismatches involving third countries at the latest in October 2016 with the aim to reach agreement at the end of 2016.
17. Finally, a few delegations have requested more time to implement the draft Directive as a whole, considering that a number of ATAD provisions would be totally new in their national tax systems. The latest Presidency compromise proposes in this respect to add one more year for national transposition, which would mean an application of the new anti-tax avoidance rules from 1 January 2019.

### **III. KEY OPEN ISSUES**

18. In the light of the debate in Coreper, the Presidency believes that the debate of Ministers should focus on the following two outstanding political issues:

*a) **Intra-EU/EEA application of approach 2a in the CFC rule (Articles 8-9)***

19. A number of delegations have the view that the approach defined in paragraph 2(a)<sup>1</sup> of Article 8 goes beyond the existing case-law of the European Court of Justice as regards its possible application within the EU/EEA.

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<sup>1</sup> The approach defined in paragraph 2(b) can apply to intra-EU/EEA situations as it stands.

20. The Presidency compromise on approach 2a, includes a "substance carve-out" rule and provides for a reversed burden of proof (on the taxpayer), which has been assessed as legally sound. However a number of delegations would prefer a wording limiting intra-EU/EEA CFC rules to wholly artificial entities and the burden of proof put instead on the tax administration. It has also been proposed by some Member States to limit the scope of the CFC rule to non-EU/EEA countries and at the same time leave the design of possible intra-EU/EEA CFC rules up to the Member States.
21. The Presidency believes that it is politically important that CFC rules are also applied within the EU/EEA and not just in non-EEA third countries, and that the Presidency compromise meets that objective, whilst respecting fundamental freedoms of the EU.

*b) Switch-over clause (Article 6)*

22. The views of delegations about whether or not to maintain this clause in the final package are split.
23. Those delegations which support the clause consider that it is a necessary complement to the CFC rule, whilst those which oppose it argue that it is not recommended by the OECD and that it is not essential to the package. The Presidency believes that making the clause optional, as suggested by some delegations, should be ruled out as that is not in line with the principle of this Directive.
24. The Presidency believes that the clause should be maintained as it currently stands to have a coherent package of anti-BEPS measures, but acknowledges the need for an exchange of views and decision at Ministerial level on this matter.

#### **IV. NEXT STEPS**

25. The Council is therefore invited:

- to resolve the remaining political issues set out in part III of the present report;
  - to reach a general approach on the Directive, on the basis of a compromise text set out in doc. 9431/16 FISC 83 ECOFIN 498, with a view to adopting the Directive, subject to receiving the opinion of the European Parliament and legal-linguistic finalisation, as an "A" item on the agenda of a forthcoming Council.
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