



EUROPEAN COMMISSION

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*Mr Stanislaw TILLICH
President of the Bundesrat
Leipziger Straße 3 - 4
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Dear President,

The Commission would like to thank the Bundesrat for its Opinion on the proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market {COM(2016) 26 final} and for its support for the Commission's efforts to promote an effective corporate tax system.

Progress in this field is one of the key elements of the Commission's strategy on combating aggressive tax planning. Given that many Member States, in their capacity as OECD Members, have undertaken to transpose the output of the base erosion and profit shifting (BEPS) project into their national laws, it has been critical for the Commission to act swiftly and make fast progress on agreeing rules for coordinating the implementation of the conclusions on BEPS in the EU.

As the opinion notes, the proposed Directive does not deal with the entire array of topics which are examined in the final reports of the OECD on BEPS. The legislative proposal in question focuses on anti-tax avoidance measures in the field of corporate taxation and is limited to fields where the Union is competent to propose legislation. In this regard, we would like to stress however that the work of the Commission on implementing the recommendations that feature in the OECD final reports is not limited to this legislative proposal. Issues linked to abuse in double tax treaties are addressed in a Commission Recommendation¹, which is also part of the Anti Tax Avoidance Package of 28 January 2016. Namely, the Commission has the view that it is more appropriate to include rules on permanent establishments and the principal purpose test in a soft-law instrument, as these items are inextricably linked to tax treaties and Member States have the authority to negotiate those bilaterally. Other examples include Intellectual Property Boxes which are part of the work of the Code of Conduct on Business Taxation. Furthermore, the Commission has commissioned a number of studies with the aim to evaluate the situation of transfer pricing within the EU and is due to come up with a wide range of initiatives in this area over the next couple of years.

¹ COM(2016) 271.

It is true that the scope of the legislative proposal laying down rules against tax avoidance practices that directly affect the functioning of the internal market does not extend to partnerships or sole proprietorships. Including partnerships or sole proprietorships would introduce a number of complexities which are primarily associated with the fact that the concept of a 'partner' includes individuals. EU secondary legislation, with the exception of the recently repealed Savings Directive, has not so far touched upon personal income taxation. In addition, given that the proposed legislation against tax avoidance only lays down minimum standards, any Member State, like Germany, where it is common to use partnerships in commercial activity, may extend the scope of the Directive to cover these cases through its implementing measures.

As regards exceptions, the proposed Directive includes very few and they have been duly justified. For instance, regulated financial undertakings within the EU are given a waiver from Controlled Foreign Company (CFC) legislation because, due to the heavy regulation in this sector, they do not risk being found artificial. As you know, artificiality in practice sets the benchmark for applying CFC rules in the EU as a result of settled jurisprudence by the Court of Justice.

Regarding the impact of the rule on limiting interest deductibility on small and medium-sized enterprises (SMEs), the Commission is confident that the safe harbour (that is to say the maximum amount of net interest cost which is fully deductible) of EUR 1,000,000 in the proposal is sufficiently high to protect such businesses' finances.

The Commission has taken note of the Bundesrat's request that the rule on exit taxation be supplemented with a catch-all provision to also cover changes in the use of assets. Whilst the Commission can see the rationale behind the suggestion, it should be clarified that changes in the use of assets appear to fall outside the scope of exit tax rules since such changes do not necessarily imply that the assets leave the taxing jurisdiction of a State. Having said this, it may be helpful to recall that Member States are free to provide for a tax charge in such cases through their national implementing rules which can go beyond the proposed legislation.

The Commission has also noted the suggestion that the tax burden linked to the trade tax (Gewerbesteuer) in Germany should be taken into account where the proposal refers to low-tax thresholds and compares them with the tax level in a Member State. Member States are free to provide for such inclusion in their implementing national rules, given that the legislative proposal only sets a minimum anti-avoidance rule.

Turning to the Bundesrat's specific concern relating to CFC legislation, it would go beyond the principles-based approach of the Directive to try to cover every single scheme of potential abuse. In the Commission's view, this amount of detail should be left to Member States who will be called upon to design implementing rules that fit into their corporate tax systems.

Similarly, as far as hybrids are concerned, the inclusion of a long series of specific business models in a Directive would be inconsistent with the nature of such an instrument. As the Bundesrat will no doubt appreciate, Directives lay down principles-based legislation as a matter of principle because they bind Member States only as to the results/objectives to be achieved whilst leaving the form and methods to national implementing rules.

The Commission would like to point out that the comments above are based on the initial proposal by the Commission which is currently in the legislative process involving negotiations in the Council in which your government is represented.

The Commission hopes that the clarifications provided in this reply address the issues raised by the Bundesrat and looks forward to continuing the political dialogue in the future.

Yours faithfully,

*Frans Timmermans
First Vice-President*

*Pierre Moscovici
Member of the Commission*