



EUROPEAN COMMISSION

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Dear President,

The Commission would like to thank the Bundesrat for its Opinions on the Commission proposals for Directives on a Common Consolidated Corporate Tax Base (CCCTB) {COM(2016) 683 final}, on a Common Corporate Tax Base (CCTB) {COM(2016) 685 final}, and on amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries {COM(2016) 687 final}.

One of the Commission's top political priorities is to make taxation fairer and more effective in the EU, as set out in the June 2015 Action Plan for Fair and Efficient Corporate Taxation in the EU. Over the past two years, the Commission has advanced an ambitious agenda to achieve this, in particular through the fight against tax evasion and avoidance. For the longer term, a more holistic reform of corporate taxation in the EU is needed, in order to achieve both fairer taxation and a predictable, growth-friendly tax environment for businesses.

With the Common (Consolidated) Corporate Tax Base, companies would have a single rulebook for calculating their taxable profits throughout the EU. The Commission's proposals will also help cross-border companies cut costs, red tape and will support innovation. In addition to bolstering anti-abuse rules, these measures will create a simple and stable tax environment which will facilitate business in the Single Market. However, Member States will remain free to decide which tax rate to apply to the share of the base that they are allocated through the formula. Where there is a harmonised tax base, tax competition tends to be transparent and without concealed harmful features. The Common (Consolidated) Corporate Tax Base will increase transparency by eliminating opportunities for tax avoidance. The Commission welcomes the Bundesrat's broad support for the aims of the proposals. In response to the specific observations expressed in the Opinions, the Commission would like to refer the Bundesrat to the attached Annex.

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

Yours faithfully,

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First Vice-President*

*Pierre Moscovici
Member of the Commission*

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ANNEX

I. Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)

The Bundesrat stresses the need for keeping consolidation an integral part of the initiative and not allowing Member States to unilaterally reject consolidation. The Commission fully agrees that consolidation is a key element of the proposed system, as underlined in its Communication to the European Parliament and the Council on building a fair, competitive and stable corporate tax system for the EU¹, which accompanied the legislative proposals.

The Bundesrat expresses the view that the Common Consolidated Corporate Tax Base should be mandatory for all groups of companies subject to corporation tax. In line with the principle of proportionality, the Commission has proposed a mandatory system only for those groups which would possess the resources to engage into aggressive tax planning schemes. Having said this, Member States would be free to make the Common Consolidated Corporate Tax Base their only corporate tax system if they so wish.

The Bundesrat stresses the importance of accompanying the common rules on the tax base and consolidation with a harmonisation of tax rates or, at least, a band/corridor. If not, it considers that high-tax Member States, like Germany, would be at a disadvantage. The Commission has repeatedly clarified that the proposal does not go beyond the calculation of the tax base under common rules, as this is a prerequisite for rectifying identified distortions in the internal market. It has no intention of interfering with tax rates, as the determination of tax levels is a matter to be decided individually by Member States, based on their national budgetary priorities.

The Bundesrat criticises the absence of intangibles from the asset factor of the formula. It should be clarified that although intangibles are not included in the formula, they are not ignored either. Specifically, they are taken into account where this is necessary to ensure that the State(s) which contributed to the creation of those intangibles (for instance, through giving deductions for research and development) can subsequently secure a taxing right on the profits generated out of successful assets.

The Bundesrat points to the need for effective controls over the principal tax authority to ensure that no advantage is taken of the power to operate the distribution of taxable shares within the group. It is also mentioned that some Member States, like Germany, will have to introduce new procedures in their administration, which will create additional costs. The Commission sees it as inevitable that a Member State has to adjust its existing procedures in order to accommodate modifications in its corporate tax framework. It is also true that the part of the proposal on administrative procedures has not yet been extensively debated in the Council on the basis of the proposal of 2011.

¹ COM(2016) 682 final.

The Bundesrat puts forward that the introduction of procedures for delegated acts entails the risk of transferring national competences to the Union (Commission) and rejects this prospect. The Commission is convinced that delegated acts, within the conditions defined by the legislator, are extremely useful in ensuring some degree of flexibility in the proposed system without compromising on the uniformity of the rules.

The Bundesrat concludes that the proposal has to be fundamentally revised, especially the rules on administrative procedures. Finally, it calls for assessing the implications of the project and in particular, its budgetary effects. On this last point, it should be recalled that the re-launched proposals are accompanied by a detailed impact assessment report. In this context, it should be clarified that, without specific data from Member States, it is not possible to gauge the detailed implications of an entire new tax system on 28 jurisdictions. This should not however discourage Member States from assessing the implications of the proposals individually at national level.

II. Proposal for a Council Directive on a Common Corporate Tax Base (CCTB)

As a number of the points that the Bundesrat raises in connection with this proposal have already been discussed under section I. above, the Commission will only address those points remaining below.

In arguing that the rules on the common tax base should be mandatory for everyone, the Bundesrat takes a step further and calls for extending the scope of the proposal to unincorporated businesses. The Commission would like to note that including unincorporated businesses in EU legislation can be a complex and risky exercise due to the variety of legal forms that exist in different Member States. In fact, the scope of all EU corporate tax Directives has so far been limited to corporations. Having said this, Germany would remain free to transpose the proposed Directive more broadly into its national corporate tax system and include partnerships into the scope.

The Bundesrat opposes a number of policy choices that the Commission has made to add new elements to the re-launched proposal:

- *It places research and development (R&D) within the competence of Member States and explains that the Commission's proposal is not in line with the approach which currently applies in Germany, that is to say direct project support.*
- *It rejects the prospect for operating the proposed allowance for growth and development (AGI), in order to neutralise the bias in favour of debt financing, on the grounds that it would reduce state revenues.*
- *Regarding the treatment of losses, the Bundesrat finds that the anti-abuse rule on losses is not sufficiently robust and its parameters are difficult to administer. Accordingly, the Bundesrat expresses its opposition to allowing cross-border loss relief, regardless of the fact that this is only temporary.*

The Commission takes due note of the observations above.

As regards the argument that the tax treatment of R&D falls within the competence of Member States, it is worth clarifying that based on the Treaties, the Union's authority in the field of direct taxation is judged by reference to a certain initiative as a whole. So, the necessity for cross-border coordinated action does not have to be substantiated for each single individual element of a proposal. From a purely policy viewpoint, the Commission is confident that it has proposed a fair and growth-friendly R&D framework, which is based on promoting job creation and innovative activity. Another issue is that a Member State may have been operating R&D incentives based on a different approach. If we wish to work out common rules, we all need to be prepared to face the prospects of a change in national approaches.

Although the Commission agrees that the rules which limit interest deductibility can mitigate the adverse consequences of debt financing, the Commission holds the view that this is not sufficient for dealing with the bias in favour of debt financing. The Commission proposal fits with broader objectives of the internal market beyond taxation. In particular, the need to tackle debt-equity bias is listed amongst the objectives of the initiative for a Capital Markets Union. It should also be stressed that the proposed rule is designed to prevent cascading effects (i.e. double deductions of equity) and to also encourage direct investment.

Regarding the treatment of losses, the Commission would like to stress the temporary character of cross-border loss relief and signal its will to work with Member States and the Presidency in the Council to come to an acceptable and robust provision on the anti-abuse rule for losses.

The Bundesrat refers to the interaction between trade tax in Germany and the Commission proposal. Germany might have to work out a solution in this regard, in order to avoid double taxation and achieve more simplicity. The fact that for the purposes of charging trade tax, profits are calculated according to the income and corporation tax rules could facilitate the situation.

The Bundesrat calls for amending the proposed rules on the common tax base, to incorporate the content of Council Directive 2016/1164 (the Anti-Tax Avoidance Directive – ATAD). The Commission would like to note that the framework of this Directive, as adopted in July 2016, has already been incorporated in the common tax base. It goes without saying that following agreement on the Anti-Tax Avoidance Directive 2 {COM(2016) 687 final}, the provision on hybrids will inevitably have to be revised, in order to reflect the latest state of play. It should however be explained that the Directive was transposed into the common tax base without options or minimum standards. This is because, contrary to the 28 national corporate tax systems, the Common (Consolidated) Corporate Tax Base constitutes a single set of corporate tax rules which are meant to constitute a single corporate tax system. The Anti-Tax Avoidance Directive as a minimum standard will be retained in the national corporate tax systems for those taxpayers who do not apply the Common Consolidated Corporate Tax Base.

III. Proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

The Bundesrat notes that the directive follows the basic approach of the OECD but diverges in several places and leaves a number of gaps. The Commission would like to point out that the proposed Directive intends to cover the same hybrid mismatch situations as addressed by the OECD. However, as the proposal is an amendment to Council Directive 2016/1164 (the Anti-Tax Avoidance Directive) it builds on the hybrid mismatch rule in that Directive, as agreed by the ECOFIN Council on 12 July 2016.

The Bundesrat regrets that the proposed Directive only covers companies subject to corporate income tax. The Commission would like to restate that, as the proposed Directive is an amendment to the Anti-Tax Avoidance Directive, it has the same scope. This implies that the proposed Directive applies to all corporate taxpayers in the EU. The Commission would like to emphasise that the proposed Directive provides for a minimum standard and that Member States may extend the scope, or apply stricter rules, if they so wish.