EUROPEAN COMMISSION

*Brussels, 15.6.2016*
*C(2016) 3516 final*

*Dear President,*

*The Commission would like to thank the Kamra tad-Deputati for its Reasoned 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 is pleased to have this opportunity to respond to the concerns it has raised.*

*The proposed legislation forms part of a broader package against tax avoidance (Anti Tax Avoidance Package) which was adopted by the College of Commissioners on 28 January 2016. The Commission, in its Action Plan of June 2015, announced a series of initiatives and actions with the aim of creating a fairer corporate tax environment, which would ensure effective taxation where profits are generated and create a better tax landscape for businesses as well as ensure further progress on tax transparency. The legislative proposal against tax avoidance makes good on this promise.*

*The actions of the Anti-Tax Avoidance Package link strongly to the G20/OECD project on Base Erosion and Profit Shifting (BEPS). In its conclusions of 8 December 2015 the Council stressed the need for common EU solutions which are consistent with the OECD BEPS measures and also ensure compliance with EU law, gave support for an effective, swift and coordinated implementation of the anti-BEPS measures to be adopted at EU level and also observed that a common EU approach in favour of certain options would bring value with a view to ensure the proper functioning of the internal market. Finally, the Council considered in its conclusions that, where appropriate, EU directives should be the preferred vehicle for implementing the OECD BEPS outputs in the EU.*

*More specifically, these Council Conclusions explained that the OECD BEPS outputs on a number of actions might be implemented, following further technical analysis, through legislative proposals focusing on international anti-BEPS aspects, without precluding the application by Member States of domestic or agreement-based provisions aimed at preventing BEPS. On this basis, the Council called the Commission to come forward with a proposal on certain international aspects and take fully into account the work done on these issues in the frame of the on-going legislative files, notably the Common Consolidated Corporate Tax Base (CCCTB).*

*Mr Anġlu FARRUGIA*
*President of the*
*Kamra tad-Deputati*
*The Palace*
*MT – VALLETTA VLT 1115*

*Aggressive tax planning is a global problem, which requires European and international solutions. In a single market founded on the free movement of goods, persons, services and capital, uncoordinated measures against profit shifting can do more harm than good. Divergent national approaches to tackling this cross-border problem can create new loopholes for aggressive tax planners as well as raise competitiveness fears to some States. Rules in one Member State can undermine the effectiveness of the rules of others. Moreover, an uncoordinated approach can bring uncertainty and additional administrative burdens for businesses.*

*The fact that the EU is an internal market with a significant degree of integration justifies why it needs to adapt the approach of the OECD to the specific EU context in order to provide effective solutions against tax avoidance practices.*

*As the Kamra tad-Deputati remarks, the Treaties do not explicitly refer to direct taxation. This is why the legal base for proposing measures in this field – Article 115 of the Treaty on the Functioning of the European Union (TFEU) – requires that the legislative proposals "directly affect the establishment or functioning of the internal market". Both the explanatory memorandum and the recitals to the Directive as well as the Communication*[1] *which introduced the Anti Tax Avoidance Package mention that only through coordinated action at the level of the Union can the Commission achieve its key objective of strengthening the average level of protection in the internal market against harmful tax practices. The anti tax avoidance measures in the proposed Directive could only bring results if they were applied in a uniform, or at least, coordinated, fashion across the internal market. If not, the landscape in the field of corporate taxation would remain fragmented and the current situation would persist, allowing unfair tax competition practices to flourish. On this point, the analysis of the explanatory memorandum on subsidiarity signals that individual uncoordinated practices "would in fact only replicate and possibly worsen the existing fragmentation in the internal market and perpetuate the present inefficiencies and distortions in the interaction of a patchwork of distinct measures. If the objective is to adopt solutions that function for the internal market as a whole (e.g. elimination of mismatches as a result of disparities in national tax systems) and improve its (internal and external) resilience against aggressive tax planning, the appropriate way forward involves coordinated initiatives at the level of the EU".*

*It is indeed the interaction between different tax systems that generates the risk of profit shifting and base erosion, whether this is an intended or unintended outcome. The fundamental freedoms give taxpayers the right to develop their economic activity across the border within the EU without facing obstacles in the form of unequal treatment. Competition in the internal market does not only suffer distortions where taxpayers are impeded from acting cross-border within the EU but also where they abuse the freedoms to engage in harmful tax practices.*

*It is understandable that the OECD refers to the need for flexibility in the field of Controlled Foreign Company (CFC) rules; it approaches the problems at a bilateral level. Yet, the EU, being an internal market where flows of income often take place tax-free amongst Member States, presents increased tax avoidance risks which can only be tackled if all Member States commit to act in the same direction.*

*It is a fact that the proposed rule on limiting the deductibility of interest may in cases affect purely domestic situations. This is an inevitable outcome which derives from the nature of the rule itself. Thus, interest limitations rules, such as the one proposed, apply across the board without distinction between domestic and cross-border situations. The fact that some purely domestic interest payments may be included does not alter the thrust of the rule as a provision with an anti-tax avoidance function which can discourage profit shifting within the EU and towards low-tax third countries. If the rule were to be limited to cross-border situations, the Commission fears that, in addition to raising several EU law compatibility questions, the rule would risk being "denatured".*

*In the light of these considerations, the aims of the Directive cannot be sufficiently achieved through action undertaken by each Member State while acting on its own. Such an approach is therefore in accordance with the principle of subsidiarity, as set out in Article 5 of the Treaty on the European Union. In response to the more technical comments in the Opinion, the Commission would like to refer to the attached annex.*

*The comments made in this reply are based on the initial proposal by the Commission which is currently in the legislative process involving discussions in the Council in which the Maltese government is represented.*

*The Commission hopes that the clarifications provided in this reply address the issues raised by the Kamra tad-Deputati and looks forward to continuing the political dialogue in the future.*

*Yours faithfully,*

| | |
|---|---|
| *Frans Timmermans*<br>*First Vice-President* | *Pierre Moscovici*<br>*Member of the Commission* |

## ***ANNEX***

*The Commission has carefully considered the issues raised by the Kamra tad-Deputati in its Opinion and would like to offer the following observations grouped by topic.*

***The broader context of the initiative: G20 and OECD action***

*The actions of the Anti-Tax Avoidance Package link strongly to the G20/OECD project on Base Erosion and Profit Shifting (BEPS), which was still ongoing when the Action Plan was adopted. In the meantime, the G20/OECD reports[2] on all BEPS actions were published (October 2015) and Member States are now expected to implement many of these recommendations in an EU law compliant manner. In this light, the conclusions of the ECOFIN Council of 8 December 2015 on corporate taxation set the framework for action at the level of the EU. The conclusions thus stress the need for common EU solutions which are consistent with the OECD BEPS measures and also ensure compliance with EU law. There is support for an effective, swift and coordinated implementation of the anti-BEPS measures to be adopted at EU level and it is also observed that a common EU approach in favour of certain options would bring value with a view to ensure the proper functioning of the internal market. Finally, the conclusions consider that, where appropriate, EU directives should be the preferred vehicle for implementing the OECD BEPS outputs in the EU.*

*More specifically, the ECOFIN Council Conclusions explain that the OECD BEPS outputs on Actions 2 (hybrid mismatches), 3 (Controlled Foreign Company rules), 4 (interest limitation rules), 6 (general anti-abuse rule), 7 (permanent establishment status) and 13 (country by country reporting) might be implemented, following further technical analysis, through legislative proposals focusing on international anti-BEPS aspects, without precluding the application by Member States of domestic or agreement-based provisions aimed at preventing BEPS. On this basis, the Commission was called on to come forward with a proposal on certain international aspects and take fully into account the work done on these issues in the frame of the on-going legislative files, notably the Common Consolidated Corporate Tax Base (CCCTB).*

*A number of Member States have already designed, or even passed, legislation for implementing the solutions set out in the G20/OECD reports against BEPS. However, such individual initiatives entail the risk that Member States act in divergent ways or give varying interpretations of the OECD BEPS measures. The Commission holds the view that action in the form of anti-tax avoidance measures in the internal market must be taken in a clear and coherent way; it should aim to strengthen Member States' collective stance against tax avoidance, while upholding the Treaty freedoms and EU competitiveness. Uncoordinated unilateral action by Member States would not adequately tackle the problem of aggressive tax planning.*

***Absence of consultations***

*The topics of the legislative proposal against tax avoidance have already been discussed with stakeholders in the framework of the proposed Directive for a CCCTB over a number of years. Member States' delegates have regularly contributed their observations at the technical Working Party on Tax Questions in the Council. Since March 2011, when the Commission adopted the CCCTB Proposal, the Working Party has met on several occasions during each Presidency and addressed technical and policy questions in detail. In addition,*

*the Commission services have liaised with all major stakeholders and heard their views on various topics of the Proposal.*

*The Commission does not share the Kamra tad-Deputati's view that the specific case of Malta has been ignored in this legislative initiative. The Commission Staff Working Document (SWD) accompanying the Anti Tax Avoidance Package[3] focuses on a mostly qualitative analysis of certain model national schemes (without naming Member States) and points to the gravity of the aggressive tax planning risks that these may present. Therefore, the underlying studies on which the SWD is based have necessarily considered the case of Malta. Having said this, it should also be recalled that when proposing legislation in the EU, the key guiding principle for the Commission is the collective benefit of the internal market.*

***Absence of an impact assessment***

*As a result of the endorsement of the 13 OECD reports against BEPS by the G20 Leaders in November 2015, many Member States, in their capacity as OECD Members, have undertaken to transpose the output of the BEPS project into their national laws. Some have decided to do so urgently. Considering this, it has been critical to make fast progress on agreeing rules for coordinating the implementation of the conclusions on BEPS in the EU. Otherwise, uncoordinated unilateral actions by Member States would run the risk of leading to a fragmentation of the market as discussed above. This would be a rather unfortunate outcome, as many of the distortions which currently exist in the internal market would be unlikely to be fixed.*

*Against this background, the Commission has made the effort to respond simultaneously to both the urgency to act, and the imperative need to avoid that the functioning of the internal market is compromised either by unilateral measures adopted by Member States (whether OECD members or not) acting on their own, or by lack of action by other Member States altogether.*

*To provide up-to-date analysis and evidence, the SWD accompanying the draft Directive gives an extensive overview of existing academic work and economic evidence in the field of base erosion and profit shifting. This is based on recent studies, amongst others, by the OECD, the Commission and European Parliament. The SWD highlights the drivers and most common identified mechanisms which, according to the OECD reports, are linked to aggressive tax planning. It summarises the conclusions of an in-depth review of key mechanisms for aggressive tax planning on a basis of analysis per Member State, as carried out on behalf of the Commission in 2015.*

*Against this background, no impact assessment was carried out for this proposal on the following grounds: there is a strong link to the OECD work on BEPS which has been the subject of extensive analysis and consultation; the SWD supplies a significant body of evidence and analysis at the level of the EU; stakeholders were extensively involved in consultations on the technical elements of the proposed rules at a previous stage; and, in particular, there is an urgent current demand for coordinated action in the EU on this matter of international political priority.*