EUROPEAN COMMISSION

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Dear Speaker,

The Commission would like to thank the Riksdag for its Reasoned Opinions on the 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}, on Double Taxation Dispute Resolution Mechanisms in the European Union {COM(2016) 686 final}, and to amend Directive (EU) 2016/1164 as regards hybrid mismatches with third countries {COM(2016) 687 final}.

The Riksdag has raised concerns in relation to the compliance of these proposals with the principle of subsidiarity. The Commission would like to make some general remarks on the political context of these proposals and their compliance with the principle of subsidiarity, before addressing the specific points raised in the four Reasoned Opinions in detail.

On the proposals for a Common (Consolidated) Tax Base

As a preliminary point, the Commission recalls that Article 115 of the Treaty on the Functioning of the European Union provides the legal base for the Union to act in this area, in line with the principles of subsidiarity and proportionality. It is on this premise that the Commission has adopted the present proposals for a Common Consolidated Corporate Tax Base and Common Corporate Tax Base, with the aim of reducing tax-related distortions in the internal market in the situations covered by the proposals.

In the explanatory memorandum that accompanies each of the two proposals for a Common Consolidated Corporate Tax Base and Common Corporate Tax Base, the Commission set out its arguments on why the objectives of these proposals cannot sufficiently be achieved through initiatives undertaken by each Member State on an individual basis. The Commission also explained how EU-wide action could more effectively tackle distortions of a cross-border nature that result from the interaction of national tax systems.

The objectives sought to be achieved through the Common (Consolidated) Corporate Tax Base system aim to tackle problems that reach beyond a single Member State and, therefore, require a common approach. The Common (Consolidated) Corporate Tax Base responds to the needs for increased growth and job creation in the internal market and also for

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countering aggressive tax planning. In the Commission's considered view, these challenges do not have a domestic focus, but develop in a cross-border framework. It is namely the interaction between different tax systems that generates opportunities for abuse or facilitates taking advantage of mismatches in the interaction of national corporate tax rules. The fact that the structure of the business sector in each Member State may differ, or that the outcome of the allocation of profits will depend on national conditions, does not change this conclusion.

The Commission is also of the opinion that the Common (Consolidated) Corporate Tax Base does not impinge on Member States' sovereignty in the field of social welfare, nor does it interfere with Member States' power to design and implement their budgetary policies. The scheme does not go further than laying down common rules for the corporate tax base and leaves it to the Member States to determine, based on their fiscal priorities and objectives, the level at which they wish to collect taxes. By eliminating opportunities for profit shifting and corporate tax abuse in the EU, the Common (Consolidated) Corporate Tax Base will even improve the ability of Member States to collect tax revenue at the level they need. In this respect, the Commission refers to the analysis of tax competition and aggressive tax planning contained in its Communication for a Fair and Efficient Corporate Tax System in the European Union[1]*.*

The Riksdag also notes that the Commission assessed the two proposals' compliance with the principle of subsidiarity jointly rather than individually. In this regard, the Commission would like to stress the unity between the two proposals, as these constitute one single initiative structured in two steps. The analysis of the impact assessment report is also outlined on the same grounds. One can still substantiate that the first step (proposal for a Common Corporate Tax Base), independently complies with the principle of subsidiarity. This is because companies with cross-border activity will only have to deal with one set of rules for calculating their tax base and this will be far simpler and cheaper than complying with many different national rulebooks. In addition, mismatches between national systems, preferential regimes and tax rulings for multinationals will be eliminated under the common base, which will help in the fight against tax avoidance.

On the proposal on Double Taxation Dispute Resolution Mechanisms in the European Union

The Commission welcomes the Riksdag's broad support to improve the existing dispute resolution mechanism regarding double taxation in the European Union and that it considers it a high priority in order to achieve increased legal certainty and a fair and efficient tax system. However, the Commission takes note of the concerns expressed by the Riksdag on the conformity of the proposed Directive with the principle of subsidiarity, in particular as regards the reason why the shortcomings identified in the existing instruments need to be addressed by means of a Directive.

In this regard, the Commission is of the opinion that the existing mechanisms in the EU, particularly the EU Arbitration Convention, do not achieve a level playing field in the different Member States, in the absence of common procedures to address the identified

[1] Communication from the Commission to the European Parliament and the Council, *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, COM(2015) 302 final, 17.6.2015.

shortcomings. This covers in particular situations of denial of access or absences of recourses in case of blocked or prolonged procedures. Furthermore, legal certainty and predictability at the level of the taxpayer can only be addressed through a common set of legally enforceable rules setting up a clear obligation of result as well as the terms and conditions of the effective elimination of double taxation and ensuring implementation of the double taxation dispute resolution mechanisms decisions consistently throughout the EU. The Council has endorsed, over many years, several recommendations from the Commission for improvements in the functioning of the EU Arbitration Convention. However, weaknesses remain and relying on such endorsements has not resulted in sufficient improvements, hence the proposal for a Directive. An EU initiative constitutes added value, as compared to the existing national rules or bilateral treaties, by offering a coordinated and flexible framework.

On the proposal amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

The proposed legislation is an amendment to the Anti-Tax Avoidance Directive[2]. As part of the final compromise proposal for this Directive, which was agreed on 12 July 2016, the Economic and Financial Affairs Council issued a statement on hybrid mismatches. In this statement the Economic and Financial Affairs Council unanimously requested the Commission "to put forward by October 2016 a proposal on hybrid mismatches involving third countries in order to provide for rules consistent with and no less effective than the rules recommended by the OECD Base Erosion and Profit Shifting (BEPS) report on Action 2, with a view to reaching an agreement by the end of 2016". The legislative proposal tabled by the Commission meets this request.

The Commission is of the opinion that the legislative proposal does not interfere with Member States' power to design and implement their budgetary policies. Both the explanatory memorandum and the recitals to the Directive as well as the Staff Working Document[3] demonstrate that only through coordinated action at the level of the Union can the Commission achieve the objective of improving the resilience of the internal market against tax avoidance risks arising from hybrid mismatches.

A mismatch in taxation is the result of the interaction of at least two tax systems, which implies that there is a cross-border dimension inherent in such a mismatch. Given that national corporate tax systems are disparate, independent action by Member States would only replicate the existing fragmentation of the internal market in direct taxation and allow mismatches to persist. The effects of mismatches can only be tackled through remedial measures at Union level. In addition, given that hybrid mismatches distort the functioning of the internal market, the application of common principles for resolving them would enhance the coherence of the internal market. An EU initiative minimises the risk of persisting loopholes or double taxation that a patchwork of national rules addressing hybrid mismatches could entail.

In response to the more technical comments in the reasoned opinions, the Commission would like to refer the Riksdag to the attached Annex.

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[2] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p. 1.

[3] SWD(2016) 345 final.

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

Yours faithfully,

Frans Timmermans
First Vice-President

Pierre Moscovici
Member of the Commission

ANNEX

The Commission has carefully considered each of the issues raised by the Riksdag in its Reasoned Opinions and is pleased to offer the following clarifications.

On the proposals for a Common (Consolidated) Tax Base

Country-specific conditions should determine the design of corporate taxation

The Riksdag takes the view that corporate taxation is closely integrated with certain specific political and economic conditions in a Member State. On this basis, Member States should be given the opportunity to take into account the specific conditions of their business sector when designing corporate tax rules. Although the Commission does not ignore the fact that there are significant structural differences in the economies of Member States, differentiated individual action by Member States would not help in tackling the identified distortions in the internal market. Instead, it would risk exacerbating the negative effects of current disparities. Having said this, the Common (Consolidated) Corporate Tax Base will contribute to a better functioning of the internal market and this collective advantage will translate into a positive and sustainable outcome for all EU Member States.

Formulary apportionment

The Riksdag criticises the proposed allocation key (formulary apportionment) on the grounds that the results it gives are highly dependent on national conditions in each Member State and will therefore differ significantly between the Member States.

It should be recalled that the Commission, in the choice of formula factors for the Common Consolidated Corporate Tax Base, based its proposal on a tried and tested methodology. In particular, these three equally weighted factors constitute the so-called 'Massachusetts formula', which the States in the USA have been using – in numerous variations – since the beginning of the twentieth century, for the purpose of charging Franchise Tax (i.e. tax on trading profits at State level). Prior to the proposal of 2011, the Commission modelled different combinations and weights of the formula factors and the results clearly demonstrated that the proposed combination of the three equally-weighted factors (assets, labour and sales by destination) offers the best option. It was found that this scheme brings the fairest results and is the most resilient to attempts of manipulation and tax avoidance practices.

It therefore follows that the allocation of profits through a formula is likely to guarantee a more efficient way for allocating profit within an integrated group that operates in a single market, as compared to traditional transfer pricing methodologies. This is because the factors have a direct relevance to the real economy since they are referring to the key income-producing elements of a company: assets, personnel and sales.

Interaction with the Anti-Tax Avoidance Directive

According to the Riksdag, the objectives of clamping down on tax avoidance and tax evasion can be achieved within the framework of the recently adopted Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal

market[4]. The Commission's Action Plan of June 2015[5] set the context for the Directive and the Common (Consolidated) Corporate Tax Base initiatives. The Directive was treated as immediate action to deal with urgent needs. Its rules offer options, in the form of a minimum standard, to fill in gaps in the existing 28 national tax systems. The Common (Consolidated) Corporate Tax Base is by itself a fully-fledged corporate tax system, which is designed to have a cross-border dimension and sets objectives that reach beyond anti-tax avoidance action. Indeed, an equally critical feature of the Common (Consolidated) Corporate Tax Base pertains to its business facilitation aspect, as part of which the new scheme would be expected to promote growth and lead to job creation in the internal market.

It follows that the rules in the Council Directive against tax avoidance practices need to be transposed into the framework of the Common (Consolidated) Corporate Tax Base without options or minimum standards because they should create a common anti-tax avoidance framework to address the specific features of one single corporate tax system. The Directive, as a minimum standard, will be retained in the national corporate tax systems for those who do not apply the Common (Consolidated) Corporate Tax Base.

The Riksdag further points out that most tax avoidance structures are set up within a group meaning that the objectives of anti-tax avoidance legislation cannot successfully be achieved in the framework of the rules on the common base (without consolidation). As a matter of principle, the Commission agrees that aggressive tax planning operations primarily take place amongst related parties. Yet, it would be very restrictive and actually defeat the purpose of the rule to limit the anti-tax defences to consolidated groups for tax purposes, such as the group envisaged under the Common (Consolidated) Corporate Tax Base. In fact, the appropriate legal instrument for accommodating the anti-tax avoidance measures is the common base (Common Corporate Tax Base) because it includes relations between associated enterprises which are not necessarily in the same consolidated group but are still able to engage in aggressive tax planning due to their association.

<u>Miscellaneous</u>

The Riksdag replicates the assessment of the Swedish government according to which the proposal for a Common Consolidated Corporate Tax Base is "vaguely and imprecisely formulated", lacks clarity on how it relates to double taxation agreements and how accounting rules may impact on the tax rules, considering that they are disconnected. Themes such as the interaction of the Common Consolidated Corporate Tax Base with double taxation agreements and the status of accounting vis-à-vis the tax provisions were extensively and repeatedly discussed amongst experts during the Council negotiations of the initial Common Consolidated Corporate Tax Base proposal and the results of such discussions are reflected in the new proposals.

[4] Council Directive (EU) 2016/1164, OJ L 193, 19.7.2016, p. 1.

[5] Communication from the Commission to the European Parliament and the Council on a fair and efficient corporate tax system in the European Union: 5 key areas for action, {COM(2015) 302 final}.

On the proposed amendment to the Directive relating to hybrid mismatches

Timeframe

The Riksdag notes that the timeframe for the national Parliaments' subsidiarity check has not been respected. The Commission would like to point out that it is the Council's responsibility to propose a timeframe for consultations on a draft legislative act. Furthermore, the Commission notes that it does not follow from Article 6, first subparagraph, of Protocol 2 to the Treaty on the Functioning of the European Union[6] that consultations in Council on a draft legislative act can only start eight weeks from the date of transmission of that act.

Absence of an impact assessment

According to the Riksdag, the proposed Directive is highly complex and difficult to assess. Furthermore, the Reasoned Opinion states that the proposal is unclear on several points, owing to the fact that it does not contain an impact assessment.

Hybrid mismatch arrangements can take a multitude of forms and often involve highly complex structures. These arrangements have been analysed by the Organisation for Economic Co-operation and Development in its report on Action Item 2 'Neutralising the Effects of Hybrid Mismatch Arrangements'. OECD/G20 members are committed to the outcomes of the Base Erosion and Profit Shifting project and to its consistent implementation. Many Member States, in their capacity as Organisation for Economic Co-operation and Development Members, have undertaken to transpose the output of the Base Erosion and Profit Shifting project into their national laws, and to do so urgently. The Commission believes that, as for the other outcomes of the Base Erosion and Profit Shifting project, it is critical to make rapid progress in coordinating the implementation in the EU of rules on hybrid mismatches involving third countries. It is indeed necessary to avoid that the functioning of the internal market is compromised either by unilateral measures adopted by some Member States (whether members of the Organisation for Economic Co-operation and Development or not) acting on their own, or by a lack of action by other Member States.

To provide a qualitative analysis, a separate Staff Working Document accompanying the proposal for a Directive gives an overview of existing findings on hybrid mismatch arrangements based on recent studies by the Organisation for Economic Co-operation and Development and the European Commission. The Staff Working Document highlights the most common identified mechanisms which are linked to hybrid mismatch arrangements. Furthermore, the Staff Working Document addresses the objectives and features of the proposed Directive.

Therefore, no impact assessment was carried out for this proposal as there is a strong link to the Base Erosion and Profit Shifting work of the Organisation for Economic Co-operation and Development, the Staff Working Document supplies a significant analysis of existing

[6] "Any national Parliament or any chamber of a national Parliament may, within eight weeks from the date of transmission of a draft legislative act, in the official languages of the Union, send to the Presidents of the European Parliament, the Council and the Commission a reasoned opinion stating why it considers that the draft in question does not comply with the principle of subsidiarity. It will be for each national Parliament or each chamber of a national Parliament to consult, where appropriate, regional parliaments with legislative powers." – Consolidated version of the Treaty on European Union, OJ C 326, 26.10.2012, p. 13–390.

findings, and stakeholders were involved in consultations on the technical elements of the proposed rules at a previous stage.

In addition, as mentioned before, there was an urgent demand in the form of a Council Statement accompanying the Council Directive laying down rules against tax avoidance practices for a proposal to be put forward by the Commission on this matter by October 2016.