FLASH REPORT

Meeting: Council – Working Party on Tax Questions (Direct Taxation)
Subjects: ATAD 2
Date and Place: 15 November 2016, Brussels

MS met to discuss the proposal for an amendment to the Anti-Tax Avoidance Directive (ATAD) as regards hybrid mismatches with third countries. The SK PR had issued a first draft compromise proposal. In this proposal the SK PR had incorporated terms and recommendations of the OECD report into the COM proposal. The SK PR admitted that the wording could be improved, but pointed out that the aim of the PR proposal was to see whether MS could agree to (the idea behind) the key changes of the amendments made.

DK said that the recharacterisation of a non-taxable reverse hybrid entity in a MS was missing. DK did not think that the OECD recommendations should be followed by all means, as long as the same result is achieved. DK could accept the COM proposal. BG found the PR proposal very complicated. MT was concerned that the PR proposal departed too much from what has been agreed in the ATAD. UK and PT thought that the PR proposal was getting in the right direction. However, it was also very confusing and needed restructuring. FR, AT and SI thought that the definitions should not be too detailed, as too much detail could create new gaps. Furthermore, FR wanted to be more precise on what is a reasonable period of time. DE, SE, AT agreed to broadening the scope, but found the PR proposal very difficult to read. IE and SI also needed more clarification. NL asked how the PR intended to proceed. The SK PR replied that it wanted to address as many comments made by MS as possible in its proposal with a view to reaching a general approach at the ECOFIN. DE asked if the SK PR intended to continue working on the basis of the COM proposal. UK asked if the definition of inclusion only regarded financial instruments. AT pointed out that the non-taxation without inclusion hybrid PE mismatch should be addressed (as in the COM proposal). EE and MT had problems with the definition on inclusion in the PR proposal. FR did not favour a carve-out for certain reverse hybrid situations leading to a deduction without inclusion. UK insisted that there should also be a primary-secondary mechanism to address mismatches between MS.

After the lunch break the SK PR supplied MS with a new, unofficial, PR compromise proposal closely reflecting the OECD recommendations. NL, SE, MT, HU, CY, LU and BE said that they needed more time to study the radical changes of the new proposal and that they doubted the usefulness of having a meeting the next day. UK welcomed the new PR proposal and mentioned that: 1) financial instrument should be defined, 2) considering undertaxation as
non-inclusion should only apply to financial instruments, 3) MS should not be obliged to requalify partnerships, as in the DK proposal and 4) addressing hybrid PE mismatches leading to non-taxation without inclusion should be optional. SE, DE and BE also had problems with addressing those mismatches. SE asked how such a rule would interfere with tax treaties. IE thought that this point should be considered together with the DK proposal to recharacterise a non-taxable reverse hybrid entity in a MS. Furthermore, SE asked for examples on double tax credits. MT expressed its concerns on the new proposal and mentioned that it seemed to provide rules for all countries in the world. HU said it first wanted to study the COM document on the interaction with Double Tax Conventions. DK wanted to verify this copy-paste exercise of the OECD recommendations first. DK thought that its point on non-taxable reverse hybrid entities was not properly addressed yet. BE had to check if it was able to agree to this point. NL preferred to have it removed. ES asked how this would interact with the new definition of D/NI. DK acknowledged that there could be some overlap, but that a binding rule would still be needed. DE welcomed that the new PR proposal was closer to the OECD, but also needed more time. DE and FR did not fully understand the definition of a deduction without inclusion in the new PR proposal. FR did not favour the optionality given to MS not to fully address reverse hybrids leading to D/NI. IT thought that the new proposal was a step in the right direction. IT and FR wanted some more clarification as to what is a reasonable period of time. IT even wanted to introduce a maximum period of time in which a payment should be included. IT supported the idea of having a primary-secondary mechanism in the EU. LU found the new PR proposal better than the first PR proposal, although not everything was clear to LU. IE thought that there might be too much flexibility in the new PR proposal. ES also expressed a scrutiny reservation on the new PR proposal.

The Presidency proposed to discuss the COM document on DTCs and to give more explanation on the new PR proposal for the meeting scheduled on 16th (morning only) November.

Reported by

| Circulation: Mr S. Quest, | Circ. Taxud D1; |
The SK PR had issued a third draft compromise text on 21st November 2016 which was discussed during the meeting. But first, the OECD gave a short presentation on the reasons for not having a secondary rule in deduction without inclusion (D/NI) cases involving a hybrid entity or hybrid PE. DK asked why the OECD did not mention the rule on reverse hybrid entities as in OECD recommendation 5.2. The OECD replied that the presentation was only about certain D/NI cases. SK PR asked whether the Directive would be less effective if it did not include a rule as in recommendation 5.2. The OECD replied that it would not consider recommendation 5.2 as dealing with a hybrid mismatch and thus being part of the core recommendations and – in reply to a question by IE - that if all countries applied the other anti-mismatch rules, rules as in recommendation 5.2 would not be needed. DK insisted on having a rule on reverse hybrid entities in the Directive. Therefore, the scope of the ATAD should be extended. After some considerations CLS thought that this would be legally possible. IE, IT, DE, ES and FR support DK, although DE was of the opinion that consequently other situations might have to be addressed as well. UK, NL and LU were against and SE, EE, MT had reservations on extending the scope of the Directive to non-corporate taxpayers.

SE reiterated its reservations on the Directive. FR and IE did not support the proposal to make the secondary rule for D/NI cases involving a hybrid entity or hybrid PE optional. In general, FR declared itself against opt-outs in the Directive. ES, UK and IT wanted to maintain that option. AT and ES turned down the idea of having a secondary rule for mismatches in the EU. UK was indifferent. COM pointed out that a secondary rule in the EU should not be needed, unless in very specific circumstances which cannot be clearly envisaged yet. CLS said that a secondary rule for mismatches in the EU is legally possible. DE was in favour of such a secondary rule because it is the OECD report. SK PR said it would maintain the secondary rule in the EU and proposed to further clarify the possible application of the secondary rule in the EU the recitals. AT was still not convinced. AT, FR, DE, DK did not support an opt-out for hybrid regulatory capital and financial traders. UK and ES wanted to have this possibility. SE asked for more clarification on the exemption for financial traders. UK replied that if a financial trader is involved, the mismatch would drop and referred to example 1.28 of the OECD BEPS report.
FR and SI thought that the Directive should be concrete on what is a 'reasonable period of time'. EE had a problem with the definition of inclusion and wanted 'calculating taxable income' to be replaced. NL, HU, BE, ES, CZ, CY, IT, and UK were concerned that the rule on a hybrid PE leading to non-taxation without inclusion (NTWI) would interfere with Double Tax Conventions (DTCs). DE suggested to delete this provision as it is not in the OECD report. COM was not convinced that the hybrid PE NTWI rule would interfere with DTCs as the MS concerned does not recognise a PE in the other state. COM explained that this rule was also agreed by the Code of Conduct group and proposed to the MS at the WP IV meeting of 26\textsuperscript{th} July 2016. COM further explained when the other provisions would not cover the hybrid mismatch addressed by the hybrid PE NTWI rule. SK PR proposed to state in the recitals that the Directive is not intended to interfere with DTCs.

SE asked if the rule on securities lending limiting the credit for withholding taxes is needed and if it could be made optional. SK PR explained that the aim is to prevent a double tax credit. IT and FR argued against (another) opt-out. The SK PR said it would provide the MS with an example. NL asked for a postponement of the implementation of the Directive until 2024 so that business would have more time to adjust to these rules. IT, FR, BG and UK were against a postponement of the implementation. SE thought that the MS should focus on the technical issues first. DK suggested extending the rule on associated enterprises to parties acting together. FR said that the minimum level of participation should always be 25% and did not support a higher threshold of 50% in case of hybrid entities. IT thought that double deduction cases should also be addressed if they occur between non associated enterprises, as in the OECD recommendations. DE and UK had doubts about the definition of payee jurisdiction, as also explained in the COM paper. Furthermore, DE thought that the provision on loss-carry forward in the case of double inclusion income should be removed to the definitions. Otherwise it could be regarded as an extra condition for applying the anti-mismatch rule. AT asked for an example on loss carry-forward in the case of dual inclusion income. FR raised a linguistic reservation on the EN text.

A COM paper on the SK PR text was circulated and (shortly) discussed during the meeting. NL shared the questions in the COM on the compatibility with EU law of the rules on diverted and deemed branch payments. IT and FR raised a scrutiny reservation. AT and RO shared the concerns about the legal drafting and said that more time was needed to work on a proper text. The SK PR thanked COM for its comments on the interaction with other Directives.

The SK PR and COM will discuss some drafting issues on 24\textsuperscript{th} November 2016. The SK PR intends to finalise the text thereafter. MS were asked to submit any comments during the rest of the day. The SK PR intends to table the compromise proposal for the Coreper of 30\textsuperscript{th} November 30. If needed, a fiscal attaché plus expert meeting on 28\textsuperscript{th} November 2016 and a WPTQ on 29\textsuperscript{th} November 2016 will be held.

Reported by

\textit{Circulation:} Mr S. Quest, Circ. Taxud D1
EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Direct Taxation, Tax Coordination, Economic Analysis and Evaluation
Direct tax policy & Cooperation

Brussels, 30 November 2016
Taxud D1/ Ares (2016) 7373765

FLASH REPORT

Meeting: Coreper of 30/11/2016

Subjects: ATAD 2

The Coreper discussed the latest compromise text of the SK PR that has been circulated on 28th November 2016 with a view to reaching a general approach at ECOFIN on 6th of December. COM welcomed the ambition of the SK PR and said that it could support the compromise text. FR, AT, IE, MT, SE, SI and EE said that more time is needed and that they are not yet in a position to support a general approach on this proposal. DK, HU, IT, PT, EL, DE, UK, PL, BE, ES, HR, LU and FI in principle support the SK PR compromise text. However, there are still issues on which MS have different, if not conflicting, views:

1. The carve-outs for the obligation to include certain deductible payments ("Article 9-4-a"), for hybrid regulatory capital issued by banks and insurers ("9-4-b") and for payments made by financial traders ("9-4-c"). FR, EL, DE and AT are opposed to any of these carve-outs. ES, PL and LU want to maintain them. HU explicitly supports the carve-out of 9-4-a as HU thinks that the Directive could otherwise interfere with its Double Taxation Conventions (DTCs). UK insisted on having the carve-outs for hybrid regulatory capital and financial traders in the Directive.

2. The rule for preventing a double tax credit in case of a hybrid transfer ("9-6"). Only SE has a problem with this.

3. A postponement of the date of implementation until 1 January 2024. Only NL wants this; FR, EL, DE, AT, PL, IE, ES, FI and IT spoke out against any postponement of the implementation.

NL and BE asked to put back the sentence that the Directive does not affect DTCs with third countries. SK PR said it would do so. DK stressed that a rule on reversed hybrid entities ("9a") should be in the Directive. EL, AT and FI supported DK. IE supports the idea but has concerns that the drafting does not sufficiently address the problem.

The SK PR said it would present the compromise text to the ECOFIN Council with a view to reaching a general approach. 9-4-a will remain between brackets. As regards 9-6 the SK PR would add a footnote on SE’s concerns. As regards the date of implementation the SK PR would add a footnote on the request by the NL. The SK PR would remove the brackets on 9a.

Reported by

Circulation: Mr S. Quest, Circ. Taxud D1
Flash Report

Meeting: ECOFIN Council, 6 December 2016

Subjects: Anti Tax Avoidance Directive 2 (ATAD 2)

The ECOFIN Council discussed the compromise text of the SK PR including the latest changes on the carve-outs for hybrid regulatory capital and financial traders which were circulated on 5th December 2016, with a view to reaching a general approach. COM said it could support the compromise text and that it hoped that the ECOFIN Council would agree on a general approach. FR, AT, MT, EL, SE, SI, LU and EE said that more time is needed and that they are not yet in a position to support a general approach on this proposal. DK, IT, PT, DE, UK, PL, BE, ES, IE, RO, BG CZ and FI could support the SK PR compromise text. FR, AT, SI and EL do not agree to the carve-outs for hybrid regulatory capital issued by banks and insurers ("9-4-b") and for payments made by financial traders ("9-4-c"). UK insisted on the carve-outs for hybrid regulatory capital and financial traders. UK argued that it already compromised on these carve-outs and that it could not accept any further changes. ES feared that the carve-out for hybrid regulatory capital could have become too limited. NL questioned whether the carve-out for financial traders would be in line with the OECD. LU said it needed to study the impact on the financial sector. AT, IT, FI, DK, RO, BG and COM spoke out against a postponement of the implementation. NL wanted a postponement of the date of implementation. The SK PR concluded that good progress had been made, that there is a broad consensus except for some outstanding issues. The SK PR proposed to stabilise the text with the exception of the provisions of 9-4-b, 9-4-c and the date of implementation. The ECOFIN Council agreed to this proposal.
Meeting: Fiscal Attaché meeting

Subjects: ATAD 2

The MT PR presented the latest compromise text which was circulated on 25 January 2017. Changes had been made in the carve-out for hybrid regulatory capital issued by banks and insurers ("9-4-b"): in sub-subpara. 9-4-b (ii) "capital" had been deleted, because it would refer to own funds only, and "is recognised as such in the taxpayer's regulatory resources" had been added, in 9-4-b-(iii) a few requirements had been rearranged and in 9-4-b-(iv) a new requirement had been added to ensure a single deduction as if the entity concerned had issued the instrument directly to the market. In recital 16 a disclaimer for the application of state aid rules had been inserted.

FR, supported by AT, EL and DE, still opposed 9-4-b because it was not needed, its scope was too broad and too vague, applying the mismatch rules would not conflict with prudential requirements and the derogation would give an unfair advantage to financial institutions. DE expressed its concerns about possible state aid and feared that the text in recital 16 would neither suffice nor contribute to the stability of the internal market. UK disagreed with FR and argued that the carve-out would not condone structured arrangements and would not give an unfair advantage. UK expressed some doubts about the further narrowing down of the carve-out. UK pointed out that the future Total Loss-Absorbing Capacity (TLAC) unlike the current regulatory requirements would require banks to issue convertible financial instruments. Furthermore, UK pointed out that the carve-out would not be obligatory for MS and that in practice a payment is actually taxed in the US with a credit for the underlying taxation. UK suggested replacing in 9-4-b-(iii) "the financial instrument has been issued" with "these features have been included" and replacing the proposed wording for 9-4-b-(iv) with: "the arrangement does not lead to a multiple deduction at the level of the consolidated group". MT PR explained that if the taxpayer issued hybrid instruments directly to the market, there could also be a mismatch that would not be covered by the directive because the mismatch would not be between associated enterprises or be part of a structured arrangement. If MS accept that outcome, why would they not accept 9-4-b which would lead to the same outcome. DK replied that these situations were not fully comparable because 9-4-b would apply to situations where the payment on hybrid capital would not be deductible at the level of the parent company. That said DK could accept 9-4-b for the sake of compromise and wondered if the objections by FR et al. were of a technical or a political nature. LU argued that the directive should not accidentally cover unintended, non-abusive mismatches. AT pointed out that tax authorities could not always be sure that a mismatch was not tax driven. Furthermore, AT reiterated that banks were not obliged to issue hybrid capital. ES and BE could accept the MT PR compromise. IT wanted to find a compromise and close the file as soon as possible. IT thought that the risk of state aid would be the responsibility for the individual MS as state...
aid is assessed on a case-by-case basis. CLS pointed out that the directive as such could not amount to illegal state aid because state aid can only be granted by MS in particular cases. CLS thought that the financial sector is different from other sectors which might be a justification. Furthermore, CLS thought that if hybrid financial instruments are issued by banks without satisfying regulatory obligations, they would not be covered by the exemption. MT PR expressed that these requirements can be met with different forms of instruments. Furthermore, MT PR said that discussions should not only focus on the legal requirements as that would fail to recognise the economic reality. SI pointed out that a distinction should be made between requirements relating to the ratio and those relating to the features of the instrument. In the latter case there would be no requirement to issue a certain type of instrument. FR said that in any event similar regulatory requirements did not apply to insurers. FR explained that TLAC would not prescribe banks what types of convertible instruments they should issue. LU replied that TLAC would cover convertible debt only and could not include equity. Furthermore, LU pointed out that legally required was something else than economically able. FR wondered how it would work in practice in case of a chain of entities, if a subsidiary in one MS could deduct a payment in one MS, but a subsidiary in another MS could not. UK replied that a MS would still be able to apply the secondary rule. FR doubted if tax authorities would be able to gather the relevant information to assess whether the requirement of 9-4-b-(iv) has been complied with. MT PR replied that just like imported mismatches tax authorities should be able to find this out in case of a group. AT said that an imported mismatch could not be compared with an exemption. AT asked what "the financial instrument has been issued in connection with financial instruments..." in 9-4-b-(iii) meant. MT PR explained that it intended to establish a link between the issuance by the taxpayer and the issuance at the level of the parent company. FR explained that the term "regulatory requirements" would be too broad as it would also include liquidity requirements. Therefore FR proposed replacing this term with "loss-absorbing capacity requirements".

The MT PR had not made any changes to the carve-out for payments made by financial traders ("9-4-c"). FR and DE, supported by AT, had an even bigger problem with 9-4-c: either it would be just a clarification which could better be included in a recital or it would prevent possible double taxation but that would not be a justification to accept a possible loophole. UK pointed out that a financial trader could fall foul of the mechanical rules of the directive while not benefitting form a mismatch. UK expressed its understanding that MS agreed that this situation should not be affected and if so, why could that principle not be laid down in an operational rule. FR replied that it could only think of one specific, theoretical case where there could be a double tax issue. MT PR concluded that MS's positions might not be that opposite and it would try to reconcile them.

NL reiterated its request for a later date of implementation although they no longer insisted on 2024. IE, DE and IT reiterated their objections to a later date of implementation. NL said it could be flexible on different options for a delayed implementation, for example on 9(3) and 9a (only). In response to a question by the MT PR NL said that a postponement of the date of implementation would not prevent those MS that so wish from already applying the rules as from 2019. SI argued that this would undermine a level playing field. SE wanted a postponed implementation for 9a until 2022. EE expressed its concern on 9a that a transparent entity in EE would become a taxable entity if the participants in that entity would not be taxed in their country of residence. CY said it could accept a compromise on the date of implementation. MT PR concluded that this was a political issue that would be likely to be decided at a higher level. Nevertheless, MT PR would try to find a formulation.
In response to a question by UK MT PR said that the HLWP of 3 February 2017 would focus on both the blacklisting and ATAD 2.

Reported by

*Circulation:  Mr S. Quest,  Circ. Taxud DL*
The MT PR presented the latest compromise text which was circulated on 1 February 2017. Changes had been made in the carve-out for hybrid regulatory capital issued by banks ("9-4-b"): this derogation would no longer apply to insurers, in sub-subpara. 9-4-b (ii) a reference to loss absorbing capital had been included, in 9-4-b-(iii) the requirements on the parent company and the structured arrangement had been modified and in 9-4-b-(iv) a new requirement had been added to ensure a single deduction as if the entity concerned had issued the instrument directly to the market. The carve-out for payments made by financial traders (formerly "9-4-c") had been removed to the definitions article and the recitals. On the date of implementation the MR PR proposed a possible postponement of the date of implementation for the whole directive.

DE, supported by EE, SE, SI and AT, said that technical issues should be solved before the proposal would go to ECOFIN to avoid technical discussions at ECOFIN. FR expressed its principal objections against the carve-outs. The optionality of the carve-out was not relevant for FR as it would still leave a gap in the rules. According to FR the carve-outs might seem to be limited in scope, but they would have a considerable financial impact. SI was content with the deletion of 9-4-c but apprehensive of the proposed alternative. IE and DK supported the PR compromise and called upon the other MS to reach an agreement as soon as possible. BE, DK and IE were of the opinion that the discussion should be limited to the carve-outs and the implementation. SE signalled that it had not agreed to the rest of the directive yet. PT, PL and SK supported the PR compromise. BE and ES expressed the hope that the date of implementation would be the only issue to discuss at the ECOFIN. UK reiterated that the carve-out for hybrid regulatory capital would be crucial. UK said it would suggest some changes to the drafting in respect of the carve-out for financial traders. UK pointed out that at the moment insurers are not subject to the same regulatory requirements as banks, but that might change in the future. Therefore, the scope of 9-4-b should be extended to insurers as a safeguard. UK thought that the wording "sole purpose" in 9-4-b-ii might be confusing. UK would submit its suggestions to the MT PR and the other delegations. DE said it could be willing to accept the derogation but only if it were convinced that the financial regulations require banks to issue the financial instruments concerned. So far DE had not been convinced. SI pointed out that there could be no carve-out if the state aid issue had not been solved. AT reiterated that it did not see the need for a carve-out for a specific sector. Furthermore, AT argued that the provision to prevent double inclusion should be optional. LU proposed as a compromise that MS would have to notify COM of the implementation of the carve-outs to
ensure that the national provisions would be justified. FR replied that it did not see a real difference between a carve-out and a carve-out with a procedure attached to it. MT PR proposed to add a review clause to the carve-outs stating that COM would evaluate their effects. As an alternative AT, supported by DE, proposed not to include the carve-outs but to add a review clause on the basis of which COM would be invited to consider whether a carve-out would be needed or not. UK concluded that a review clause could only be useful as a compromise and that submitting two separate, alternative review clauses to ECOFIN would only invoke the same debate on the carve-outs. MT PR proposed to introduce a sunset clause on the carve-outs. LU replied that considering the advancement of the Total Loss-Absorbing Capacity (TLAC) requirements it would have to know the date of termination. DK said that the date could be left to ECOFIN. FR said it could be willing to consider a sunset clause but only on the condition that the carve-outs would be terminated automatically. MT PR explained that the automatic termination would trigger a review by COM and that the clause could only be prolonged if all MS agreed to that. COM stressed the need to find a compromise and said that an agreement was within reach. It would be up to the MS to insert a review clause.

NL reiterated its request for a later date of implementation and said it could be flexible on different options for a delayed implementation. DE thought that the arguments put forward by NL were not convincing. Other MS also pointed out that ATAD 2 should have the same date of implementation as ATAD 1. MT PR concluded that the date of implementation would be for the ministers to decide.

SE wanted a postponed implementation for Article 9a on reverse hybrid entities until 2022. EE expressed its concerns on 9a and, like SE, did not consider this article to be finalised. EE had circulated some changes to 9a before the HLWP. DK objected to these changes. MT PR concluded that it would try to solve these issues bilaterally with EE and SE.

After the first round of discussions the MT PR circulated a new compromise text (see annex) including a sunset clause in 9-4-b with 31.12.2012 as the final date. Furthermore, the new proposal includes a specific review clause on 9-4-b stating that the review report could be accompanied by a legislative proposal. As regards the date of implementation the MT PR has added a possible postponement of the implementation of Article 9-3 and 9a.

In the second round UK did not support the sunset clause, but could support a review clause. LU agreed with the UK and preferred a review clause rather than a sunset clause. FR was positive about the sunset clause but could not agree to a review clause. DE also supported the idea of a sunset clause but felt that the date should be brought forward. DK welcomed the sunset clause but agreed with DE that 2021 was too long. IT and AT also agreed with DE that the date of sunset clause should be brought forward.

SI and AT insisted that there should also be a sunset clause for financial traders. SE welcomed option 2. NL could live with option 1, but needed to verify the exact date at political level; they could not support option 2 as the scope was not broad enough. DK did not support option 2 but could live with option 1 if limited to one year. EE recalled that their concerns had not been addressed.

The MT PR said it had taken note of the preliminary comments expressed, invited further written comments, and reserved the right to further amend its text. A new text will be issued
by Tuesday noon. The MT PR confirmed its intention to put this text to COREPER and ECOFIN on 21.2.2017. A GRI fiche is currently being prepared.

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<th>Circulation: Mr S. Quest,</th>
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Annex: Presidency compromise text dated 3 February 2017