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THE EUROPEAN UNION**

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NOTE

from: General Secretariat
to: Delegations

Subject: ECOFIN report to the European Council on Tax issues

1. The European Council conclusions of 1/2 March 2012 devoted to growth invited the Council to report back regularly on various tax issues, starting in June 2012.
2. Delegations will find attached the ECOFIN report to the European Council on Tax issues, as endorsed by the Council (ECOFIN) on 22 June 2012.

ECOFIN REPORT TO THE EUROPEAN COUNCIL ON TAX ISSUES

1. This report covers various issues mentioned in the European Council Conclusions of 1/2 March 2012¹ devoted to growth and for which ECOFIN was requested to report back by June 2012. Building on discussions in the context of the Council High Level Working Party on Tax issues, it sets out to what extent "concrete ways to improve the fight against tax fraud and tax evasion, including in relation to third countries" are being developed by the Council. Against this background the report gives an overview on the state of play of Council work regarding some key legislative proposals, which were specifically mentioned in the conclusions, such as Energy Taxation, the Common Consolidated Corporate Tax Base, the Financial Transactions Tax, the revision of the Savings Tax Directive and the Negotiating Directives for Savings Taxation agreements with third countries.
2. The priorities set out in the programme of the Danish Presidency illustrate that the Council's work has been focusing on how to combat the evasion of taxes and tax fraud over the last few months. Ensuring effective tax revenues in Member States has indeed gained in importance following the financial crisis and in times of tight budgets. Discussions on tax issues during the Danish Presidency have also allowed to highlight the potential role of taxation as an incentive/disincentive in the context of broader challenges such as growth stimulation, dealing with climate change and drawing appropriate conclusions from the financial crisis.

¹ EUCO 4/3/12 (items 9 and 21).

3. The above considerations have been taken into account during discussions on the following files over the last six months. Some of the files have made considerable progress. Further efforts will be necessary on others, before a decision or an adoption by the Council (unanimity) will be possible. The Commission continues to emphasise the importance of rapid agreement on the key legislative proposals.

Savings Taxation

4. The Danish Presidency has endeavoured to reach progress on two inter-linked files which would make a difference in combating tax fraud and evasion:
 - 2008 proposal to amend the Council Directive 2003/48/EC on taxation of savings income in the form of interest payments;
 - the draft Mandate for negotiations with five third countries (Switzerland, Liechtenstein, Andorra, Monaco, San Marino) on equivalent measures concerning savings income.
5. The current Savings Taxation Directive provides for automatic exchange of information on savings income between Member States, while Austria and Luxembourg have a transitional arrangement that provides for withholding tax on savings income. The transitional arrangement shall expire and all Member States shall take part in reporting and automatic exchange of information when certain conditions requiring a number of unanimous Council decisions are fulfilled.²
6. The Directive is linked to the Savings Taxation Agreements with Switzerland and the other third countries which provide for withholding tax on savings income from these countries.

² Art. 10 (2) of the Savings Taxation Directive.

7. The practical application of the Directive and Agreements has revealed inefficiencies and significant loopholes which facilitate tax fraud and evasion. In 2008, the Commission submitted a proposal to amend the Directive in order to increase its efficiency.
8. During the previous Presidencies agreement was reached on the amendments to the Directive, except for a few outstanding technical questions.
9. However, Austria and Luxembourg were not ready to move towards final adoption of the directive before level playing field concerns were addressed. It should be excluded that industries of Switzerland and the other third countries could benefit from tighter regulation in the EU. These two Member States therefore underlined the necessity to ensure parallelism between envisaged changes to the Savings Taxation Directive and upgrading the current Savings Taxation Agreements with Switzerland and the other third countries.
10. In order to address these level playing field concerns pro-actively, the Commission presented a recommendation for a mandate to initiate negotiations with Switzerland and the other third countries. On the basis of the work done by the previous Presidencies, the Danish Presidency has finalised the technical work on the mandate.
11. Against the background of international developments, including in the field of tax cooperation and administrative assistance, the Presidency submitted the draft mandate to the Council in May 2012.

This draft contains the authorisation to the Commission to negotiate with the third countries the adoption of measures, which are equivalent to the amendments of the Council Directive 2003/48/EC and also encompass an examination of international developments, as foreseen in the review clauses of the existing agreements.

12. All Member States, except for Luxembourg and Austria, could agree to its adoption. Luxembourg and Austria are fully prepared to adopt a mandate as well as the proposed amended directive, but insist that the mandate should be strictly limited to negotiations with the third countries about the equivalent measures. Without prejudice to this position, concerning the mandate to examine international developments Austria and Luxemburg insist that such mandate can only be given after an agreement within the EU on the meaning of "international developments".

All other Member States are of the view that the mandate shall at least include a provision allowing to upgrade the current provision regarding exchange of information on request to the internationally agreed standard, in accordance with current bilateral practices of the Member States and of the relevant third countries.

13. It was therefore not possible to reach agreement on this dossier at this stage.

Common Consolidated Corporate Tax Base (CCCTB)

14. The Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) was tabled by the European Commission on 16 March 2011, as a contribution to more growth friendly taxation advocated by the Europe 2020 strategy.

The aim of the proposal is two-fold:

- to establish a common EU system for the calculation of the corporate tax base, which would exist in parallel to the national systems of the Member States and would be optional for companies to opt-in;
- to allow for consolidation of profits and losses of the groups of companies that have opted-in into the system.

15. Building on work during the Hungarian and Polish Presidencies, the Danish Presidency has organised four meetings of the Working Party and focused the technical discussion in the Council Working Party on the calculation of the common corporate tax base from the perspective of a single taxpayer.

It has given priority to discussions on certain aspects, e.g. limitation of interest deductions, limitation on carry forward of losses, allocation of profits to a permanent establishment, the general anti-abuse rule, Controlled Foreign Companies and anti-abuse rules on hybrid mismatches of entities and financial instruments.

Based on discussions in the Working Party, the Presidency has also presented a first compromise text, for certain parts of the proposal, which has been discussed and given initial comments by the Member States. Although interest was expressed by many delegations to pursue work on that basis a number of Member States maintained substantial objections to the proposal. Discussion revealed that further work at the technical level will be necessary before an agreement or decision can be reached.

16. To be noted that several elements of the proposal – e.g. consolidation, the formula apportionment and administrative procedures – have not been examined so far and should be considered.

Amendment of the Interest and Royalties Directive

17. The 2003 Interest and Royalties Directive aims at reducing the instances of Member State of source levying a withholding tax on a payment of interest or royalty, while a Member State of receipt taxes the same payment. The main aim is to ensure fair taxation, while avoiding double-taxation between Member States.
18. In 2011 the Commission made a proposal aimed at widening the scope of the directive, so that the directive would cover more interest and royalty payments, and at adding a new requirement to be met for a cross border payment to be exempt from withholding tax: the recipient of the payment has to be 'subject to tax' in the State of its establishment on the income derived from the payment.
19. A number of Member States are of the opinion that this new requirement of 'subject to tax' should take into consideration that some Member States submit royalties to a special tax regime with the intention of promoting growth-friendly policy – research and development. In their opinion, a 'subject to tax clause' should still allow the companies benefiting from such tax regimes to benefit from the Directive.

20. On the other hand, a number of Member States maintain that since one of the purposes of the Directive is to tax cross border interest and royalties payments once and since the proposal is aimed at widening its scope, the Directive should not lead to the total exemption or very low taxation of these payments.

To do so, some Member States are of the opinion that the new 'subject to tax' provision should set a minimum level of taxation in a Member State of receipt as a condition for a payment to be exempt from tax in a Member State of source.

21. It was therefore not possible so far to reach agreement on this dossier.

Amendment of the Energy Taxation Directive

22. In April 2011 the Commission presented to the Council a proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity ("the Energy Taxation Directive" or "the ETD"). The proposal presented by the Commission seeks to bring the ETD more closely into line with the EU's energy and climate change objectives as requested by the March 2008 European Council.
23. The proposal has been discussed in the Council's Working Party on Tax Questions on several occasions under successively the Hungarian, Polish and Danish Presidencies. The Danish Presidency has attempted to pursue overall compromises within the framework of the proposal while keeping in mind the request from the European Council to support the EU energy and climate targets and taking into account at the same time more recent EC Conclusions (1/2 March 2012) focusing on growth. Inter alia, the following issues have been discussed on the basis of the Commission proposal, while some delegations maintain substantial objections to the proposal:

- The principles for a new structure of the taxation of energy products and its implementation in national legislation.
- A phasing in of the new minimum levels of taxation as well as appropriate transitional periods.
- Abandoning the proposal for binding rules for national tax levels above the minimum levels so that Member States are free to choose their national tax levels above the minimum levels; the possibility to introduce a limitation of the gap between national taxation of petrol and diesel.
- Establishment of tax exemptions or tax reductions for the CO₂ component in order to avoid overlap between the CO₂ component and the EU Emission Trading Scheme (ETS) while ensuring that the rules shall lead to the same result, irrespective of whether the Member States apply a separate CO₂ taxation or a combined single rate.
- Possibilities to amend and/or maintain tax reductions or tax exemptions for particular uses and/or products currently in force, provided that equal treatment of Member States, regardless of national choices made around the tax base, shall be ensured.

24. The Danish Presidency has prepared a note with a view to an orientation debate of the Council (ECOFIN) on 22 June 2012, explaining the state of play of the discussions on the Commission proposal and inviting Ministers to discuss and endorse orientations for future work.

The common system of Financial Transactions Tax (FTT)

25. The Proposal for a Council Directive on a Common System of Financial Transactions Tax (FTT), amending Directive 2008/7/EC, was presented by the Commission on 28 September 2011. Three additional meetings have been arranged by the Danish Presidency due to political interest in the proposal as well as requests from a number of Member States to expedite the process. The Working Party completed the first technical examination of the proposal on 6 March 2012.
26. The state of play on this file has been discussed at the Council (ECOFIN) on 13 March 2012, with subsequent discussions at the informal ECOFIN on 30 March 2012. These discussions revealed that, while continuing further technical examination of the Commission's proposal, it is necessary to look also at the possibilities for alternative solutions.
27. The subsequent Working Party meetings on 26 April and 4 May 2012 have followed the above two-track approach outlined by the Council while focusing primarily on possible amendments to the current FTT proposal. The possibilities for a step-by-step approach have been discussed. In addition, elements of a stamp duty were discussed in order to comply with the two-track approach. Also, the Commission services have provided seven additional technical documents providing further explanation of certain elements of the proposal, including a paper regarding different methods of taxing financial activity. The Presidency decided to devote the last meeting to possibilities for alternative solutions (second track), i.e. Financial Activities Tax (FAT), Bank levies, etc.

28. Some Member States are of the opinion that, if the first track – the introduction of a tax on financial transactions – were to be explored further with the aim of an introduction of the tax in a not too distant future, further work should focus on a step-by-step approach. This could mean starting with a narrow based transactions tax mainly applying the tax to secondary market transactions with shares, bonds (but not government bonds) and possibly UCITS, with a possibility to extend the tax to other financial instruments (including e.g. derivatives) at a later stage. The discussions in the Working Party also show that a number of Member States are against harmonisation of financial sector taxation at EU-27 level. Some would prefer the second track (consisting of identifying other ways of regulating or taxing the financial sector and the extent to which these require action at EU-27 level, consistent with the principle of subsidiarity).
29. The Danish Presidency has prepared a report with a view to an orientation debate of the Council (ECOFIN) on 22 June 2012, which explains the state of play of the discussions on the Commission proposal.

VAT and Excise duties

a) Adoption of Council conclusions on the future of VAT

30. On 6 December 2011, the Commission transmitted to the Council a Communication on "The future of VAT – Towards a simpler, more robust and efficient VAT system tailored to the single market".

31. Following discussions in the Working Party, the Presidency drew up draft Council conclusions on the future of VAT in general and on the priorities for further work as well as a report reflecting the state of play of the discussions.

After further discussion in the Working Party, the Council on 15 May 2012 adopted conclusions and took note of the Presidency's report of the discussions on the Commission's communication on the future of VAT.

32. The Council conclusions emphasise, among others, that the current financial and economic situation is difficult and complex and demands a strong fiscal consolidation of national budgets, as reflected in the European Council Conclusions of 1/2 March 2012.³ They also recall "that the European Council invited 'Member States, where appropriate, to review their tax systems with the aim of making them more effective and efficient, removing unjustified exemptions, broadening the tax base, shifting taxes away from labour, improving the efficiency of tax collection and tackling tax evasion'. This should be taken into account at EU level in the implementation of the objectives of the Communication. Value Added Tax constitutes a major source of revenue for the national budgets and reform of the current EU VAT system should, in particular, aim at making it more effective and efficient, removing unjustified exemptions and broadening the tax base, in order to contribute to fiscal consolidation and growth".
33. The Council conclusions on the Future of VAT represent an important step forward towards the implementation of a new EU VAT Strategy.

³ EUCO 4/3/12.

b) Adoption of Council Conclusions on a Special Report from the Court of Auditors

34. The Court of Auditors transmitted on 15 December 2011 Special Report No 13/2011 entitled "Does the control of customs procedure 42 prevent and detect VAT evasion?".

In accordance with the applicable procedures, Coreper asked the Working Party on Tax Questions to discuss the special report.

35. On 13 March 2012, the Council adopted conclusions on the report as prepared by the competent Council Working Party. These conclusions took note of the special report and encouraged, i.a., "Member States to continue to strengthen cooperation in the field and to stay vigilant as to the prevention and detection of VAT evasion in connection with customs procedure 42".

c) Adoption of new rules on Administrative Cooperation in relation to Excise Duties

36. On 14 November 2011, the Commission proposed new rules on administrative cooperation in the field of excise duties, which would speed up the collection of duties and improve Member States' controls on revenue.

The new Regulation replaces the existing rules, to better reflect the introduction, in April 2010, of the computerised Excise Movement and Control System (EMCS).

Computerising exchange of information will make it easier and faster to collect the excise duties that are due.

37. Following discussions at the Working Party on Tax Questions, the Council on 2 May 2012 adopted the proposed new Regulation on administrative cooperation.
38. The regulation makes an important contribution in times of budgetary consolidation, since effective tax collection is crucial for Member States. In the Single Market, tax administrations must be able to exchange data with other Member States quickly and efficiently, in order to collect their revenues properly.

Tax coordination

39. The HLWP also discussed coordination between Member States in the field of taxation.

a) Code of Conduct Group (Business taxation)

40. Avoidance of harmful practices remains a key priority for Member States in the area of taxation. They recognise that ongoing work in the Code of Conduct Group (Business Taxation) of the Council over the last years has substantially contributed to the avoidance of such practices in EU Member States and in third countries. The Group reports every six months to ECOFIN Ministers on progress achieved. This successful work should therefore be carried forward on the basis of the work programme approved by the Council in 2011.

b) Other tax coordination issues

41. The HLWP has identified some areas for possible tax policy coordination beyond June 2012, such as:

- FATCA (US Foreign Account Tax Compliance Act): Discussions with US counterparts on how to implement this US legislation efficiently have started, as agreed in the HLWP.⁴ Informal meetings have allowed to clarify a number of practical elements on the way forward. The Council HLWP should take stock of progress made, discuss how to facilitate further discussions with the US and identify elements for a coordinated approach for further talks.
- The HLWP could have an exchange of views on important tax files under discussion in the OECD / G8 / G20 context, which are relevant for further work within the EU. If appropriate, representatives of these fora/organisations could be invited to make presentations at the HLWP.
- In cases where it has not been possible to adopt EU legislation so far, the HLWP could discuss possible ways forward.
- Exchange of best practices could focus on the following areas:
 - practical experience of Member States in dealing with tax evasion and fraud, including in relation to third countries; efficiency of tax collection;
 - experiences with growth friendly tax structures.⁵

⁴ Letter by Presidency and Commission sent to Treasury Secretary Timothy Geithner, dated 24 March 2011.

⁵ Taking into account recommendations contained in the 2012 Annual Growth Survey (docs 17229/11 + ADD 4).