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Communication from the Commission to the European Parliament and the Council – Anti Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU

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A fair and efficient corporate taxation is a cornerstone of a deeper and fairer Single Market which is a Commission priority[1]. Some companies use aggressive tax planning techniques to exploit loopholes in tax systems and mismatches between national rules to reduce their tax liabilities. These activities undermine the fair burden sharing amongst taxpayers and fair competition between businesses. It also means fewer revenues available to finance public goods or investment. The economic crisis of recent years requires contributions to the consolidation of public finances from all taxpayers. However, while many citizens face an inescapable increase in taxes, the public perception is that other economic actors and in particular multinational enterprises can get around contributing their fair share by their capacity for tax optimization, thus artificially lowering their taxable income.

The Commission has been taking several initiatives to counter corporate tax avoidance, based on a central principle: ensuring that taxes are paid where profits are generated. The EU has enhanced transparency by ensuring automatic exchange of information on tax rulings. It also actively contributed to the OECD/G20 work on the Base Erosion and Profit Shifting (BEPS)[2] project. Furthermore, the European Parliament has called for more action and coordination in addressing the fight against tax avoidance.[3]

This document first introduces the issue at stake, the scope of the package, the consultation process and complementary initiatives at the EU level. Secondly, it presents more in depth the analysis of the key drivers and possible solutions to address tax avoidance. The third section presents the objectives and features of the proposed policy initiative in line with Member States' commitments.

1. Introduction

1.1. What is the issue?

The existing rules for corporate taxation need reform. Corporate tax rules no longer fit the current economic environment, which is increasingly globalised, mobile and digital. The increasing complexity of business models and corporate structures has made it easier to shift profits and more difficult to define which country is supposed to tax a multinational enterprise (MNE)'s income. It is also more difficult for Member States to protect their tax base. Domestic rules cannot be fully effective given the cross-border dimension of many tax planning structures and the use of arrangements which artificially relocate the tax base to another jurisdiction within or outside the Union. In addition, relying on unilateral and domestic measures may fragment the Single Market.

Following the crisis and the increased revenue needs, the OECD, endorsed by the G20, launched the BEPS project that came to completion in October 2015. It proposes a package of measures for a comprehensive, coherent and co-ordinated reform of the international tax rules against BEPS to reinforce the current international tax rules and stabilize national tax bases. The OECD/G20 initiative aims at reforming key areas of the system to ensure that taxes are paid where economic activity takes place. To reach this objective, new standards are proposed. The EU fully supports the OECD/G20 conclusions as many of the issues addressed are of relevance for the EU and are important for the international competiveness of the EU

[1] http://ec.europa.eu/priorities/internal-market/index_en.htm
[2] http://www.oecd.org/ctp/beps.htm
[3] See European Parliament (2015a) and European Parliament (2015b)

enterprises as well. Also, the EU plays an important role in addressing these questions as it is one of the biggest players in the world.

It is essential for the European Union that Member States implement the OECD/G20 BEPS outcomes in a coordinated way. This is necessary to ensure that the Single Market is not hampered by differing applications and interpretations of the proposed standards. For Member States, the introduction of unilateral anti-abuse measures might be seen as a valuable short term solution for fixing the most pressing issues. However, the EU has to make sure that an increase in national anti-abuse measures does not undermine the Single Market, the creation of a Capital Markets Union and the overall attractiveness of Europe at the global level. With its Single Market and a common currency in the Euro area, the EU offers unique advantages to citizens and businesses. The economic integration within the EU has increased the welfare of citizens by lowering prices, increasing choices and removing borders. Also, it has helped businesses to access larger markets, tap new sources of finance and allocate their activities according to economic determinants rather than being limited by national borders. This has led to an increased mobility of goods and services and production factors within the EU which is most notably the case for capital. This mobility has improved the allocation of resources. Since the taxation of income from activities across the EU remains largely a national task, it is important to ensure a smooth and coordinated implementation of the new standards to avoid frictions in the Single Market due to tax obstacles.

EU action will restore a level playing field across companies active in the Union. Tax avoidance and aggressive tax planning by multinational companies distort price signals in the Single Market and thereby the allocation of resources. Companies which use tax avoidance strategies are more profitable and face lower capital costs compared to purely domestic companies. This issue has to be addressed at the EU level to ensure a level playing field for different types of companies.

Action at the EU level needs to ensure a coordination of Member States' corporate tax policies within the Single Market, but also of Member States' approach to external base erosion threats. Tax avoidance is a cross-border and global phenomenon. Tackling the erosion of Member States' tax base and the shifting of profit outside of the EU calls for a common approach towards third countries. The fight against tax avoidance at EU level is only as strong as its "*weakest link regarding interactions with low- or no-tax and secrecy jurisdictions*"[4], as recalled by the European Parliament.

1.2. Economic evidence of profit shifting and base erosion[5]

Company taxation has come under scrutiny by tax authorities, tax experts and the general public in recent years. More and more evidence suggests that considerable amounts of corporate income can avoid taxation through the use of cross-border structures. The business models of multinational companies have become more complex, intra-group transactions have multiplied and multinationals' integrated value chains make it difficult to determine where profits are created. Governments struggle to determine, within the current set of international tax rules, which country should be allowed to tax which part of a multinational's income.

Shifting income across borders can lead to a loss of corporate income tax revenues. Many companies can adjust their internal prices whereby they have a possibility to shift

[4] European Parliament (2015a)
[5] For more details, see European Commission (2015b)

profits to low tax jurisdictions. Digitalisation has made it easier for companies to organise their activities through offshore financial centres, and to create sophisticated structures for tax planning purposes. While differences in the statutory corporate income rates are one important driver of profit shifting, also the effective tax rates companies face play a crucial role since these rates also reflect preferential regimes and loopholes in national tax bases.

The existence of profit shifting and base eroding practises is demonstrated in many academic studies. Although the extent of these practices and its impact on total tax revenues is hard to measure, it might be considerable. The OECD/G20 BEPS report on Action 11 estimates the revenue loss at the global level at 4 to 10 per cent of CIT revenue, i.e. USD 100 to 240 billion annually at 2014 levels.[6] In a study comprising 51 countries, the IMF concludes that "the (unweighted) average revenue loss is about 5 % of current CIT revenue – but almost 13 per cent in non-OECD countries"[7]. Additionally, a recent study commissioned by the European Parliamentary Research Service finds that the revenue loss from profit shifting within the EU amounts to about EUR 50-70 billion, equivalent to 17-23 per cent of corporate income tax (CIT) revenue in 2013[8]. Based on a measure of total corporate profits in a given country and average collection rates across countries, the study estimates how much revenue should have been collected in the absence of any profit shifting.[9] It is important to note that the method only captures profit shifting within the EU[10], and it therefore does not take into account profit shifting from and to other countries.

Other studies have not attempted to measure the total revenue loss, but are nonetheless indicative of the potential size of the problem. For instance, Lee et al.[11] find that 22 per cent of companies in their sample have a large tax gap, meaning that the gap between the taxes they would theoretically owe according to where they generate their revenues and the total tax they actually pay amounts to at least 10 per cent. Egger et al.[12] compare the tax liabilities of multinationals with those of domestic firms and find that foreign-owned affiliates in high-tax European countries pay 32 per cent less tax than domestically owned companies. A similar study by Finke[13] for Germany finds a gap of 27 per cent. Further, there is evidence on the sensitivity of affiliates' pre-tax profits to corporate income tax rates. Sullivan[14] and Clausing[15] show that pre-tax profits are higher in low-tax jurisdictions than in high-tax jurisdictions; a meta-analysis conducted by Heckemeyer and Overesch[16] finds that an increase in the corporate income tax rate by 1 percentage point leads to a lowering of affiliates' pre-tax profits by 0.8 per cent.

These observations have led to a more general debate on fairness and efficiency in taxation in the light of fiscal adjustment needs.[17] Addressing base erosion and profit shifting has become even more relevant in the context of rising concerns on fiscal sustainability following the economic and financial crisis: public debt levels have increased

[6] For a review of existing indicators and the associated challenges, see OECD (2015i).
[7] IMF (2014)
[8] Dover et al. (2015)
[9]The study develops further a method initially introduced in a study by the IMF (2014).
[10] Excluding Spain, Hungary and Finland
[11] Lee et al. (2015)
[12] Egger, P., W. Eggert and H. Winner (2010)
[13] Finke, K. (2013)
[14] Sullivan, M. (2004)
[15] Clausing, K. A. (2011)
[16] Heckemeyer, J. H. and M. Overesch (2013)
[17] According to Eurobarometer (2012) 88% of Europeans (EU-27) supported tighter rules on tax avoidance and tax havens: http://ec.europa.eu/public_opinion/archives/eb/eb78/eb78_cri_en.pdf

substantially in the EU from around 58% of GDP in 2007 to a forecasted value of 88% of GDP in 2015[18]. As a result of the crisis, many governments cut expenditures and increased taxes, notably on consumption, to consolidate public budgets[19]. The use of tax planning strategies by multinational corporations has created a debate about their fair contribution to government budgets. Another relevant consideration includes the more indirect effect that tax avoidance of some companies could have on the tax morale of all taxpayers.[20]

While corporate income taxation and capital taxation more generally have a growing international dimension due to the mobility of the tax base, tax policy and administration remain primarily a national responsibility. All decisions on taxation in the EU are taken unanimously by the Council. This has in practice limited the degree of co-ordination and harmonization in this policy field in the EU as a whole as well as in the Euro area. In a Union of 28 Member States, unanimity has effectively reduced the chances of progress in legislation to safeguard national tax bases while ensuring a smooth functioning of the Single Market.

1.3. Scope of the Anti-Tax Avoidance Package

The EU has been active to find solutions to the issues of profit shifting, but more remains to be done. In the EU, the debate around corporate taxation began to emerge as cross-border activity increased with economic and political integration. It focused primarily on preventing problems which could hamper the development of the Single Market, such as double taxation and tax discrimination. The issues and challenges of corporate tax systems in an economic union as well as their role for competitiveness vis-à-vis third countries were highlighted in the 1962 Neumark report followed by the 1970 van den Tempel report and the 1992 Ruding report. In 1998 the Code of Conduct for business taxation was established to limit harmful tax competition and identify specific tax regimes considered harmful. In 2001, the Commission presented a Communication identifying concrete steps to eliminate tax obstacles to cross-border trade in the EU. This was followed by 10 years of technical preparation, culminating in the Commission's 2011 proposal for a Common Consolidated Corporate Tax Base (CCCTB). In 2012, the Commission adopted and Action Plan to strengthen the fight against tax fraud and tax evasion[21]. Among others, the plan led to an amendment of the Parent-Subsidiary Directive to allow Member States the use of unilateral measures against profit participating loans as well as to the establishment of the Platform for Tax Good Governance. The transparency package proposed in March 2015 contains a number of proposals to improve transparency and information flows between tax authorities. This has led to the adoption by the Council in December 2015 of a Directive on the automatic exchange of information on advance cross-border tax rulings and advance pricing arrangements. In June 2015, the Commission adopted the Action Plan for Fair and Efficient Corporate Taxation in the EU[22]. The Commission initiatives take into account the work

[18] European Commission (2015b)

[19] For example, the average standard VAT rate has increased by 2 percentage points over the period 2007-2014 in the EU. For a detailed description of tax reforms in Member States, see the Taxation Trends in the European Union 2015 and the Report Tax Reforms in EU Member States 2015.

[20] Evidence from behavioural economics shows that fairness (e.g. that the tax administration or the government treats taxpayers in a consistent and transparent way) is an important determinant of tax morale. If anecdotal evidence in the public opinion suggests that some taxpayers receive a different treatment or can easily avoid taxes, this might deteriorate the willingness to contribute to public revenues via taxes in general. Alm and Torgler (2006) analyse in an empirical study a number of tax morale determinants.

[21] European Commission (2012a)

[22] European Commission (2015b)

carried out by the Expert Group on Taxation of the Digital Economy[23], as well as the OECD's work on the digitalisation of the economy[24]. This will be complemented by a package of initiatives to reform and modernise the EU VAT system, paying particular attention to the interaction with the Digital Single Market[25]. Finally, the Commission has been investigating the tax ruling practices of Member States under State aid rules since 2013 and adopted three decisions in October 2015 and January 2016.

The CCCTB initiative will provide a holistic solution to the problem of tax avoidance in Europe, with a fundamental reform of corporate taxation. A common corporate tax base would effectively mean that a single set of corporate tax rules would be available for companies to calculate their taxable income, instead of the current co-existence of 28 corporate tax rules. The consolidation would allow companies to offset losses in one Member State against profits in another. The CCCTB would in general reduce compliance costs and complexities for businesses in the Single Market. In addition, it would be highly effective in tackling tax avoidance as it would limit the opportunities to manipulate tax rules and exploit mismatches between tax systems. The Action Plan for Fair and Efficient Corporate Taxation in the EU announced the relaunch of the CCCTB. A two-step approach will be followed focusing firstly on the common tax base and secondly on the consolidation.

While work on the relaunch of a CCCTB is progressing, there is a need to act now to avoid varying interpretation of the OECD/G20 BEPS measures, which would also create administrative burdens and uncertainty for businesses. The Commission proposal covers elements that have already been discussed extensively and presents a pragmatic approach bringing together initiatives to enhance effective taxation and transparency in the Single market. The Action Plan laid the basis for developing an EU approach to implementing some international aspects of the common base that are linked to the BEPS project. This would allow for a coordinated implementation of the new international standards agreed in the OECD/G20 BEPS package. The Action Plan states that these elements should be agreed in the Council within 12 months. Member States have extensively discussed anti-avoidance rules, not only in the context of the BEPS project, but also in the context of the CCCTB proposal presented by the Commission in 2011. The following rules were discussed: interest limitations, exit taxation, switch-over rules, general anti-abuse rule (GAAR), controlled foreign companies (CFC) rules, hybrid mismatches and definition of permanent establishment.

The Anti-Tax Avoidance Package will ensure that tax is paid where the value is generated and that tax information is effectively accessed. The EU uses all tools at its disposal securing a common approach: two legally binding Directives, a Commission recommendation, as well as a Commission Communication preventing together aggressive tax planning within the EU and against external base erosion threats. This package is structured around the following 4 initiatives:

- A proposal for an Anti-Tax Avoidance Directive
- A Recommendation on Tax Treaty issues
- A proposal for an amendment to the existing Directive on administrative cooperation to implement the OECD agreement on Country-by-Country Reporting
- A Communication on External Strategy for Effective Taxation

[23] Commission Expert Group on Taxation of the Digital Economy – Report, 2014,
[24] OECD (2015a)
[25] European Commission (2015d)

Those four initiatives are accompanied by a Chapeau Communication that clarifies the context, objectives and overall articulation of the package.

The proposal aims at setting a common minimum level of protection against tax avoidance. This coordinated approach should safeguard the integrity of the Single Market, level the playing field on tax for Member States and limit the distortions in the European Union. The policy proposal also ensures that rules and measures taken to fight tax avoidance are compliant with EU law and respect the fundamental freedoms as well as fundamental rights as enshrined in the EU Charter of Fundamental Rights.

1.4. Consultation process

The package builds on the outcomes of the OECD/G20 BEPS project as well as on discussions on the international aspects of the CCCTB (including Council working parties and Council meetings), discussions in the Code of Conduct Group and in the Platform for Tax Good Governance on the external agenda. The various aspects of the package have therefore been subject to extensive consultations, on top of a consultation on the totality of the package.

1.4.1. Anti-Tax Avoidance Directive

Measures in relation to domestic tax rules build on the outcomes of the OECD/G20 BEPS project, as well as on the discussions on the international aspects of the CCCTB and the discussions in the Code of Conduct Group (in particular with regard to hybrids).

As detailed in section 2 below, the works on the BEPS project have been very inclusive, with public consultations on a majority of actions and the release of discussion draft and working documents for all actions. Most Member States have been involved in the technical discussions on the actions.

The international aspects of the CCCTB were subject to technical discussions preparing Council meetings, to discussions in the High Level Working Party on Taxation and to consultation with stakeholders. The need to align developments in the CCCTB and BEPS initiatives emerged in the Council discussions. The 2014 Italian Presidency started promoting the development of an EU/BEPS work programme (EU/BEPS Roadmap) and focusing the discussion on international and BEPS-related aspects of the CCCTB proposal. The Italian Presidency has encouraged the consistency with parallel OECD initiatives, while respecting EU law. The approach has been endorsed by the High Level Working Party on Taxation and followed by the subsequent Presidencies. European Council Conclusions of 18 December 2014 called for "*an urgent need to advance efforts in the fight against tax avoidance and aggressive tax planning, both at the global and EU levels*"[26]. The discussions on the EU BEPS Roadmap have continued into 2015. The aim has been to feed the OECD discussion and pave the way for a smooth implementation of the OECD recommendations, given the EU specificities.

1.4.2. Recommendation on Tax Treaty issues

Tax treaties issues have been extensively discussed in the context of the OECD/G20 BEPS project, in Action 6 (preventing Treaty Abuse) and 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). Both Actions have been subject to public consultations, in addition to the involvement of most Member States in technical OECD groups.

[26] European Council Conclusions, 18 December 2014, EUCO 237/14, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/146411.pdf.

1.4.3. Directive implementing the OECD/G20 Country-by-Country reporting

The introduction of new transparency requirements for companies was the subject of a public consultation launched by the Commission in 2015. The public consultation attracted much interest with more than 400 responses received. It reflected the possibility to implement the OECD/G20 BEPS recommendation on non-public Country-by-Country Reporting (action 13) and/or the disclosure to the wider public of certain tax information from companies. Action 13 was itself subject to extensive consultation, within the framework of the BEPS project.

1.4.4. Communication on External Strategy for Effective Taxation

The EU Strategy towards third countries has been extensively discussed in the context of the Platform for Tax Good Governance. Items such as the criteria used by Member States to list third countries for tax purposes, or the need for a common EU approach were discussed in this context. The publication of the overview of third countries listed by Member States for tax purposes, which was a first step towards an EU approach to assessing and listing third countries has generated lot of useful debate and involvement with Member States, third countries and stakeholders. This topic has been further discussed in High Level Working Group. Furthermore, the proposed approach would reflect many of the elements considered essential by the European Parliament with regard to third countries.

1.4.5. Anti-Tax Avoidance Package

The Anti-Tax Avoidance Package was presented and discussed on 30 November 2015 with Member States' representatives, business and non-governmental organizations (NGO) at the Platform for Tax Good Governance.

Several Member States shared the Commission analysis on the need to have a fair taxation framework in the Single Market, on the importance of the external dimension in a globalised world and on the fact that a common approach is preferable. Most Member States expressed their interest in relying on a Directive which is perceived as more effective and providing legal certainty. Some Member States highlighted the importance of allowing for some flexibility. Among the fields that should be prioritised for a common EU approach; many Member States cited hybrids, CFC legislation and interest limitation rules. Exit taxation and switch-over rules were also mentioned by a number of MS. A small number of Member States mentioned that they did not favour the choice of a Directive as the tool to address issues such as the definition of Permanent Establishment or Treaty abuse. According to some Member States, the Country-by-Country reporting to tax authorities could be implemented through an amendment to the Directive on Administrative Cooperation. On the external strategy, several Member States favoured including a good governance clause in trade agreements with third countries. Furthermore, various Member States stated being in favour of replacing the present compilation of national lists by a common EU list based on common criteria with a coherent approach.

Business and NGOs were similarly consulted on the package. Business groups cited that the Single Market was good for job, investment and growth, and asked that these goals be kept in mind. Many were supportive of further coordination of anti-avoidance measures and could see that this could help minimise administrative burdens for businesses operating throughout the EU. There was an emphasis on ensuring that this did not create additional compliance costs which were disproportionate to the benefits. NGOs were on the whole supportive of the proposal. They pushed for the inclusion of measures which would ensure profits were effectively taxed in the EU. They asked that the impact of these measures on developing countries should be borne in mind. Finally, they emphasised their position that Country-by-Country reporting should be made public.

1.5. Complementary existing initiatives

The Anti-Tax Avoidance Package complements existing initiatives and forums to ensure effective taxation and transparency. For example, the work on introducing a new anti-abuse clause in the Interest and Royalties Directives has been progressing, and Ministers of Finance have agreed to focus attention on this aspect in the short-term. Other initiatives and forums include the Code of Conduct, the Joint Transfer Pricing Forum, the Platform for Tax Good Governance or measures to increase transparency, which are explained in greater details below.

1.5.1. Code of Conduct

The Code of Conduct for Business Taxation[27] was set up in 1998 to address harmful tax competition within the EU. It has assessed a great number of national measures and in around 100 cases the Member States concerned have agreed to abolish or modify ("roll back") the regimes that have been found harmful under the criteria of the Code of Conduct.

In 2009, the Code Group started examining anti-abuse issues related to hybrid mismatches. It first concentrated its work on hybrid entities and hybrid Permanent Establishments (PE). Guidance on hybrid entities mismatches was agreed in December 2014, on the basis of the fixed alignment approach. It would compel Member States to change their qualification of the hybrid entity from transparent to non-transparent in double deduction situations, or from non-transparent to transparent in deduction/no inclusion cases. Guidance was agreed in June 2015 for hybrid PEs, and in December 2015 for hybrid entities in situations involving third countries (based on a modified fixed alignment approach).

Recently, the Code Group has looked extensively into patent box regimes that exist in 10 Member States. In 2014, it agreed that preferential regimes, such as patent boxes, should be aligned with the "modified nexus approach", discussed in the OECD/G20 BEPS project (Action 5 on Harmful Tax Practices). Under this approach, the tax benefits must be directly linked to the underlying research and development activities. The agreement on the modified nexus approach re-establishes the link between taxation and economic activity.

The Code Group has also entered into dialogues with third states in order to try to ensure that tax regimes in those states comply with the criteria of the Code of Conduct. So far an agreement has been reached with Switzerland and a dialogue has been initiated with Liechtenstein. The 2015 Work program of the Code Group provides that this exercise should be continued and expanded to further third states.

In the Action Plan for Fair and Efficient Corporate Taxation in the EU, the Commission recommended reforming the Code Group in order to focus more on ensuring effective taxation and react more efficiently to instances of harmful tax competition.

1.5.2. Joint Transfer Pricing Forum

The EU Joint Transfer Pricing Forum (JTPF), which was set up in 2002, assists and advises the Commission on transfer pricing tax issues. It proposes non-legislative solutions to practical problems posed by transfer pricing practices in the EU. It is made up of

[27] Resolution of the Council 98/C 2/01

representatives from Member States, businesses and NGOs. The work of the forum centres around two areas:

- the Arbitration Convention, which is a specific dispute resolution mechanism for transfer pricing cases; and
- other transfer pricing issues.

The June Action Plan called on improving the transfer pricing framework in the EU in order to better align the transfer pricing outcomes with value creation.

1.5.3. EU Platform for Tax Good Governance & the 2012 Recommendations

In 2012, together with the Action Plan to strengthen the fight against tax fraud and tax evasion[28] the Commission adopted two recommendations. The first one, on Aggressive Tax Planning[29], recommends the adoption by Member States of a GAAR that would counter aggressive tax planning schemes that fall outside the scope of their specific anti-abuse rules. Member States are also encouraged to include in their double tax conventions a provision that limits the application of rules intended to avoid double taxation. The second one, on measures intended to encourage third countries to apply minimum standards of good governance in tax matters,[30] provides criteria for identifying third countries that do not meet those minimum standards. It also lists actions that Member States may take in relation with third countries that comply - or not - with those standards. The Platform for Tax Good Governance, made of representatives from Member States, businesses and NGOs, was set up in 2013. It was mainly tasked to support work on aggressive tax planning and good governance in tax matters. It also monitored the application of the two Recommendations. The mandate of the Platform was expanded in 2015, following the Action Plan.

1.5.4. Transparency measures

In March 2015, the Commission launched a package of measures to boost tax transparency. It included a proposal for an automatic exchange of information on tax rulings, which was adopted by the Council in December 2015. All advance cross-border tax rulings and advance pricing arrangements will be subject to an automatic exchange of information as from January 2017[31]. It is in line with work carried out in the context of the OECD/G20 BEPS package on harmful tax practices, and goes even beyond.

Further to the introduction of non-public Country-by-Country reporting, which is covered by the Anti-Tax Avoidance Package, the possibility to disclose to the wider public certain tax information of companies is currently being examined by the Commission, following a public consultation.

1.6. Initiatives by the European Parliament

The European Parliament is closely examining the issue of tax avoidance, in particular through the Economic and Monetary Affairs (ECON) Committee and the Tax Rulings and Other Measures Similar in Nature or Effect (TAXE) Committee.

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[28] European Commission (2012a)
[29] European Commission (2012c)
[30] European Commission (2012b)
[31] However, information will need to be communicated on all advance cross-border rulings and advance pricing arrangements issued, amended or renewed since January 2014. Information on advance cross-border rulings and advance pricing arrangements issued, amended or renewed in 2012 and 2013 will need to be exchanged if those rulings are still valid.

There is a clear message from the European Parliament that tax avoidance needs to be addressed. As highlighted in the TAXE committee's report, corporate tax avoidance has a direct effect on Member States budgets and the sharing of tax efforts across economic factors. It also creates competition distortions and unfair tax burden sharing among taxpayers. Citizens and SMEs shoulder a disproportionate burden, compared to large MNEs[32]. *"[T]his situation risks feeding democratic mistrust and affecting overall tax compliance*".[33]

The lack of joint definition or guidelines in the EU when it comes to elements such as anti-abuse rules or notion of permanent establishment[34] is identified by the Parliament as an area where there would be a need for coherence at EU level. The fight against tax avoidance also requires action with regard to bilateral tax treaties and insufficient anti-abuse provisions therein.[35]

The studies and in-depth analyses prepared for the EP shed light on aggressive tax planning techniques, and possible solutions. A paper by Vella presents "*some of the most significant techniques and mechanisms used by MNEs for base erosion and profit shifting as identified in the BEPS project*"[36], i.e. exploitation of transfer pricing rules, debt shifting, hybrid mismatch arrangements, Tax Treaty abuse, artificial avoidance of Permanent Establishment status, and tax rulings. In another paper on patent box regimes, Evers recalls the usefulness of exit taxation on "*the full earnings value of the [Intellectual Property] IP*"[37], although it is not easy, she points out, to identify the 'true value' of IP.

The Parliament supports the OECD/G20 BEPS Reports. However, as the OECD approach is based on soft law, it should be "*complemented by a proper legislative framework at EU level to address the needs of the single market, e.g. in the form of an anti-BEPS directive going beyond the OECD BEPS initiative in areas that are not sufficiently covered*".[38] The Commission should also envisage "*areas in which the Union should go further than the minimum standards which the OECD recommends*"[39].

Enhancing transparency is important in order to increase "public accountability of MNCs and supporting tax administrations in their investigations."[40]

The European Parliament has also looked into great details at the role of third countries in tax avoidance. It is committed to tackle the challenge posed by the so-called "tax havens". In its report on tax rulings, the Parliament has pointed out how lack of transparency in the global tax system enables multinational companies to limit their tax bill by shifting their profits outside the Union. To make progress on this front, the Parliament has invited the Commission to continue its work on a common EU approach towards third-country tax jurisdictions. The Parliament "*reiterates that genuinely European lists, regularly updated and based on comprehensive, transparent, robust, objectively verifiable and commonly accepted indicators, would be more effective as a means of promoting good tax governance and changing tax behaviours towards and within those jurisdictions*"[41]. In the same report, the European

[32] See also VVA Consulting and ZEW (2015)
[33] European Parliament (2015a)
[34] European Parliament (2015a)
[35] European Parliament (2015a)
[36] Vella, J. (2015)
[37] Evers, L. K. (2015)
[38] European Parliament (2015a)
[39] European Parliament (2015b)
[40] European Parliament (2015a)
[41] European Parliament (2015a)

Parliament has also pointed out that the OECD approach to the matter cannot be considered sufficient, as it focuses on tax transparency and the exchange of information but do not sufficiently address the harmfulness of tax practices[42].

2. Analysis of key drivers and possible solutions to address tax avoidance

This section presents the results of the OECD/G20 BEPS package and the results of a study on aggressive tax planning (ATP) commissioned by the Commission services. This should provide a broad overview of the mechanisms used by MNEs to avoid taxes and of the solutions that can be envisaged to defeat such ATP structures.

2.1. The OECD/G20 BEPS Project

The OECD report on Addressing Base Erosion and Profit Shifting[43] showed that the roots of BEPS were not to be found in single rules or provisions, but rather in the interplay of various national tax rules. It also showed that the corporate tax rules and international standards had not kept pace with the changing environment, and identified a lack of information and data availability.

In September 2013, the G20 Leaders endorsed the OECD *Action Plan on Base Erosion and Profit Shifting*[44], which was made up of 15 actions. This marked the start of a two-year work to deliver on the Action Plan. The process allowed for the involvement of a large number of countries and a variety of stakeholders. All OECD and G20 countries, including a vast majority of Member States, worked together. Even more countries[45] were associated to the process through their direct involvement in technical groups[46]. Regional structured dialogues were also organised which means that in total more than 90 countries have contributed to the works on the BEPS project. The European Commission was also associated. For all 15 actions, discussion drafts and working documents were made public. There have been more than 1,400 submissions from industry, advisers, NGOs and academics. In addition, 11 public consultations were held with stakeholders. The BEPS Final Reports were published in October 2015 and endorsed by G20 leaders in November 2015. Most Member States, in their capacity as OECD members, have therefore engaged to implement the outcome of the Final Reports.

The final package proposes to reforming key areas of the system to ensure that taxes are paid where economic activity takes place. A first set of measures focuses on improving the *coherence* of the international tax framework. Examples are the taxation of CFCs, limits on interest deductibility or conditions on the application of preferential tax regimes for intellectual property ('patent boxes'). A second set of measures aims at enhancing *transparency*, for example by requiring multinationals to provide country breakdowns of key items relevant for taxation ('country-by-country reporting') or by exchanging information on a range of rulings. The third set of measures aims at strengthening *substance* requirements for example in the area of transfer pricing rules.

[42] European Parliament (2015a)
[43] OECD (2013a)
[44] OECD (2013b)
[45] All EU Member States that are OECD countries, plus Croatia, Latvia and Lithuania.
[46] OECD/G20 BEPS, Explanatory Statement, 2015 Final Reports

Below, the actions that are most relevant to this policy initiative are presented, followed by an overview of the remaining BEPS actions that are mostly catered for by ongoing or existing initiatives at EU level.

2.1.1. Neutralising the Effects of Hybrid Mismatch Arrangements (Action 2)[47]

Hybrid mismatch arrangements exploit differences in the tax treatment of an entity or an instrument under the laws of two or more jurisdictions to achieve double non-taxation. These types of arrangements are widely used by taxpayers and result in the shifting of considerable amounts of profits and the substantial erosion of countries' taxable basis. Several OECD reports have identified hybrid mismatch arrangements as playing a major role in aggressive tax planning and highlighted the negative impact of such arrangements on tax revenues as well as competition, transparency and fairness

The Final Report focuses on three possible outcomes under a hybrid mismatch arrangement: a deduction/no inclusion outcome (D/NI outcome)[48], a double deduction outcome (DD outcome)[49] or an indirect D/NI outcome[50].

The OECD/G20 recommends aligning the tax treatment of an instrument or an entity in one jurisdiction with the tax treatment in the counterparty jurisdiction in order to neutralise hybrid mismatch arrangements. The recommended rules are divided into a *primary response and a defensive rule*, in the event that the primary response is not applied by the parent or payer jurisdiction according to the case.[51]

2.1.2. Strengthening CFC Rules (Action 3)[52]

CFC rules are designed to prevent taxpayers with a controlling interest in a foreign subsidiary from stripping the tax base of their country of residence by shifting income into a CFC.

However, existing CFC rules are not always adapted to the current business environment and do not permit to tackle BEPS effectively. Taxpayers have developed practices that allow them to circumvent CFC rules. For example, they may manipulate the definition of CFCs through the choice of the legal form of the subsidiary, the fragmentation of the level of control, or the splitting of income across multiple subsidiaries.

The OECD/G20 Final Report puts forward options for the design of CFC rules in the form of six building blocks: (i) definition of a CFC, (ii) CFC exemptions and threshold requirements, (iii) definition of CFC income, (iv) rules for computing income, (v) rules for attributing income to shareholders, and (vi) rules to prevent or eliminate double taxation. It aims at

[47] For more details, refer to OECD (2015b)
[48] Cross-border payments that are deductible under the laws of one jurisdiction and are not included in the ordinary income under the laws of the other jurisdiction where the payment is received.
[49] Payments that produce two deductions in respect of the same payment, through for example deductible hybrid payments or deductible payments made by a dual resident
[50] Outcome where payments are deductible under the rules of the payer jurisdiction and are set-off by the payee against a deduction under a hybrid mismatch arrangements.
[51] i) For D/NI outcomes: the primary response consists in denying deduction of the income at the level of the payer, while the defensive rule would be to include hybrid payments in the ordinary income of the payee.
ii) For DD outcomes: the primary response is to deny either the parent or the resident company deduction of the income. The proposed defensive rule denies the payer deduction of the income in the case of deductible payment made by a hybrid.
iii) For indirect D/NI, the primary response consists in denying the payer deduction of the income (no defensive rule is deemed necessary in that case).
[52] For more details, refer to OECD (2015c)

preventing the stripping of jurisdictions' tax bases, while avoiding excessive administrative and compliance burdens for companies as well as double taxation issues.

Regarding the definition of CFC income, it is worth noting that the Final Report presents a non-exhaustive list of approaches to attribute income that raises BEPS concerns:

i) a *categorical approach*, which consists in classifying income into categories, usually according to its legal designation (as dividend, royalty, IP income, etc.), but also according to other criteria, such as the relatedness of parties or the source of income. CFC rules would apply to those categories of income;

ii) a *substance-based approach*, which looks at whether the attribution of income to a CFC refers to genuine activity, either through a threshold test or a proportionate analysis;

iii) an *excess profit returns test*, which targets extraordinary returns on equity (notably, in the form of interest or royalties) that would remain with the CFC even after transfer pricing rules have been applied.

States may choose one of these approaches or combine two of them. The above-described approaches can be applied on an entity-by-entity basis[53] or on a transactional basis[54].

2.1.3. Limiting Base Erosion via Interest Deductions and Other Financial Payments (Action 4)[55]

Jurisdictions usually treat debt and equity differently for tax purposes; interest on debt is often treated as a deductible expense for the payer, while dividends are generally not deductible and are subject to some form of tax relief such as exemption. This may lead to the following scenarios:

i) companies may take advantage of this difference in treatment in a cross-border context by claiming relief for their interest expense in one jurisdiction while equity returns are taxed on a preferential basis in another jurisdiction;

ii) companies can also place high levels of debt into subsidiaries, thus using excessive interest deductions to avoid paying tax on local profits.

In order to address these problems, many jurisdictions have introduced a wide range of rules addressing the use of third party and intragroup interest. However, companies have managed to circumvent existing rules on the limitation of interest deductibility because of the fluidity of money and the flexibility of financial instruments. This, in turn, has led countries to create new rules or amend existing ones, causing considerable complexity in the implementation of such rules and undermining the attractiveness of countries for investment.

The OECD/G20 Final Report sets out a best practice recommendation which provides for a general limit to interest deductions, through a *fixed ratio rule*[56], and additionally, gives States the option to allow for a higher deductibility of the net interest cost by taking into account the

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[53] Under the entity approach, either all or none of the income will be included depending on whether the majority of that income falls within the definition of CFC income.

[54] Under the transactional approach, some income can still be included even if the majority does not fall within the definition of CFC income, therefore being in general more accurate in the attribution of income.

[55] For more details, refer to OECD (2015d)

[56] The fixed ratio rule limits an entity's net interest deductions to a fixed percentage of its gross operating profits measured using earnings before interest, taxes, depreciation and amortisation (EBITDA). This rule, which is relatively straightforward to apply, ensures that an entity's interest deductions are directly linked to its economic activity. The possible ratio would be in a range of 10%-30%.

indebtedness of a taxpayer's entire accounting group, i.e. *group ratio rule*. States are also recommended to complement their regimes through *targeted rules*.

According to the Final Report, countries may apply a *de minimis* threshold, whereby entities with net interest expenses below that threshold would not be caught by the general interest limitation rule. Countries may also allow entities to carry-forward disallowed or unused interest expense for use in future years. Countries may choose to exclude interest expense incurred on specific third party loans used to fund public-benefit projects, subject to certain conditions. Furthermore, the bank and insurance sectors will be subject to specific rules to be completed in 2016 by the OECD, given the important role played by interest in the business models of such groups.

2.1.4. Preventing Treaty abuse (Action 6)[57]

Action 6 addresses Treaty shopping and other Treaty abuse strategies whereby taxpayers seek to obtain the benefits of a Tax Treaty in situations where those benefits were not intended to be granted. Treaty shopping refers to arrangements through which a person who is not a resident of a Contracting State is able to access the benefits granted by a Treaty to a resident of that State.

Recommendations regarding treaty shopping situations, which form the bulk of the Final Report, are divided in three parts:

i) introduction of a clear statement that Tax Treaties seeks to eliminate double taxation without creating opportunities for tax evasion and avoidance ;

ii) adoption of a specific anti-abuse rule similar to the limitation-on-benefits (LOB). This rule targets treaty shopping cases that can be identified on the basis of pre-defined criteria, such as the legal nature of certain entities, the level of ownership or the general activities of these entities ;

iii) inclusion in Tax Treaties of a more general anti-abuse rule based on the principal purposes of transactions (the principal purposes test or "PPT" rule).

The Report however recognises that the combination of an LOB rule and a PPT test may not be appropriate or necessary for all jurisdictions and allows some flexibility in their application. Furthermore, the Report includes targeted rules to address other forms of treaty abuse.

The OECD/G20 Final Report also refers to the interaction between tax treaties and domestic anti-abuse rules, with some treaty abuse strategies that need to be dealt with through domestic anti-abuse provisions. The Report acknowledges for example that nothing prevents the application of exit taxes, but suggests ways to resolve possible double taxation issues.

2.1.5. Preventing the artificial avoidance of Permanent Establishment Status (Action 7)[58]

The definition of permanent establishment (PE) comprised in Article 5 of the OECD Model Tax Convention provides that the business profits of an enterprise are taxable in a State only to the extent that the enterprise has in that State a PE. Action 7 deals with tax avoidance techniques aimed at circumventing this definition. In particular,

- Use of commissionaire arrangements and similar strategies

[57] For more details, refer to OECD (2015f)
[58] For more details, refer to OECD (2015g)

Commissionaire arrangements are arrangements through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through this type of arrangement, a company is able to sell its products in a State without having a PE to which the profits generated by the sales would have been attributed and thus to avoid corporate income tax on those profits. This results in a shifting of profits out of the country where the sales take place. Similar results can be achieved through similar arrangements where contracts that are substantially negotiated in a State are not concluded in that State because they are finalised or authorised abroad, or where the person who concludes contracts is an "independent agent" to whom the exception of Article 5(6) is applicable.

- Exploitation of the specific activity exemptions

Article 5(4) includes a list of exceptions (the "specific activity exemptions") according to which a PE is deemed not to exist where a place of business is only used to carry out the activities that are listed in that paragraph. However, given the changes in business conditions, including the digitalisation of the economy, activities that were previously considered to have a preparatory or auxiliary character may now correspond to core business activities. Also, strategies based on a "fragmentation of activities" where used by companies to benefit from the exception of Article 5(4).

- Splitting-up of contracts

The splitting-up of contracts between closely related parties in order to avoid the application of Article 5(3) which applies to construction sites.

The OECD/G20 Final Report on Action 7 proposes an updated version of the definition of PE which should make it more resilient against artificial structures to circumvent its application, in the light of the above-mentioned concerns.

2.1.6. Re-examining Transfer Pricing Documentation (Action 13)[59]

Tax authorities lack information for identifying whether companies have engaged in transfer pricing and other practices that may result in the artificial shifting of profit. In order to enhance transparency for tax authorities, the OECD/G20 developed a three-tiered standardised approach to transfer pricing documentation. It consists in:

- a "master file" that will be available to all relevant tax administrations, and will provide high-level information on an MNE's global business operations and transfer pricing policies;
- a “local file” that is specific to each country and will provide detailed transactional transfer pricing documentation;
- a "Country-by-Country Report" that will provide on an annual basis and for each jurisdiction where the MNE operates the amount of revenue, profit before income tax and income tax paid and accrued. It will also include information on the number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction. Finally, it will identify per jurisdiction all active entities and their business activities. The country-by-country report would only be required from MNEs with annual consolidated group revenue equal to or exceeding EUR 750 million.

It is foreseen that the master file and the local file would be transmitted by the MNEs to local tax authorities. Country-by-Country reports should be communicated to the jurisdiction of tax

[59] For more details, refer to OECD (2015k)

residence of the parent company. The Country-by-Country reports would subsequently be shared between jurisdictions through automatic exchange of information.

The proposed approach should induce taxpayers to give consideration to transfer pricing, while providing tax authorities with relevant information for audit and risk assessment purposes.

It is worth noting that the Joint Transfer Pricing Forum developed in 2006 the EU Transfer Pricing Documentation ("EU-TPD"), which is broadly in line with the "master file" and "local file" approach developed under this action. The EU-TPD will be reviewed to take the conclusions of BEPS Project into account. [60]

2.1.7. Other OECD/G20 BEPS Actions

Action 1: Addressing the Tax Challenges of the Digital Economy[61]

The report concludes that the digital economy does not create specific issues with regard to BEPS, but might exacerbate some. This was taken into account in the work done on the remaining actions, for example in Action 3 on CFC (with a modification of the definition of CFC income to subject income related to the digital economy to taxation), in Action 8-10 (with transfer pricing guidance revised to address risks raised by the digital economy) or in Action 7 on the definition of Permanent Establishment (to prevent taxpayers from circumventing the actual standard through the use of new business models).

Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance[62]

The Final Report primarily addresses preferential regimes used by taxpayers to artificially shift profits and the lack of transparency attached to certain tax rulings. The "nexus approach" was selected as the appropriate methodology to define the substantial activity requirement with a view to realigning taxation of profits with the substantial activities that generate them. As regards transparency, it was agreed that certain types of rulings, that could give rise to BEPS concerns, would be subject to a compulsory spontaneous exchange.

This work is in line with actions taken at the EU level. In particular, the Code of Conduct agreed that preferential regimes, such as patent boxes, should be aligned with the nexus approach. The Directive on the automatic exchange of tax rulings, recently agreed in the Council, goes even beyond Action 5[63].

Actions 8-10: Assuring that Transfer Pricing Outcomes are in line with Value Creation[64]

The BEPS Action Plan asked for the arm's length principle to be clarified and strengthened in relation to transfer pricing. The arm's length principle, which requires that transactions between associated enterprises be priced as if the enterprises were independent, operating at "arm's length", and which is used by many countries, has indeed proven vulnerable to

[60] EU Joint Transfer Pricing Forum, JTPF Program of Work 2015 -2019 (section 3.2.2), http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf005 2015programmeofwork.pdf

[61] For more details, refer to OECD (2015a)

[62] For more details, refer to OECD (2015e)

[63] For example, the type of rulings exchanged is broader and the exchange is foreseen with all Member States.

[64] For more details, refer to OECD (2015h)

manipulation by taxpayers. This has resulted in outcomes in which the allocation of profits is not aligned with the economic activity that produced the profits.

The Report on Actions 8 to 10 contains revised transfer pricing guidance which tackles the following issues: a) transfer pricing issues related to transactions involving intangibles, b) contractual allocation of risks and the resulting allocation of profits to those risks, and c) certain other high-risk areas. The revised guidance aims at ensuring that operational profits are allocated to the economic activities which generate them.

At the EU level, transfer pricing issues are dealt with in a comprehensive manner with the assistance of the Joint Transfer Pricing Forum. The Commission will monitor Member States' implementation of the new rules and will consider whether stronger rules are required to prevent manipulation.

Action 11: Measuring and Monitoring BEPS[65]

The Report focuses on measuring the scale of BEPS and its economic impact, as well the effectiveness of BEPS-countermeasures. It estimates the revenue loss at the global level, as mentioned in section 1.1 above. Analyses of BEPS are however constrained by the lack of data and the complexity of disentangling effects of tax avoidance from real economic factors. The report identified six indicators that would allow monitoring BEPS, but highlighted the need for new data in order to refine the measurement of the scale and impact of BEPS. In that respect, the Country-by-Country reporting, foreseen under Action 13, should prove useful. The OECD, in cooperation with OECD members and BEPS associates aims at (i) publishing new corporate tax statistics, (ii) reporting periodically on estimated revenue impact of BEPS countermeasures and (iii) further producing and refining analytical tools and BEPS indicators. A second set of recommendations consists in (i) improving public reporting of business tax revenue statistics, (ii) improving non tax data that are relevant to BEPS (such as Foreign Direct Investments associated with resident special purpose entities); and (iii) looking at best practices and encouraging more research on BEPS to better understand BEPS and disentangle BEPS from real economic effects and non-BEPS tax preferences.

Action 11 examines not only the significant revenue losses caused by BEPS but also its adverse economic effects, "*including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure*."[66] Finally strong anti-avoidance rules are found to reduce profit shifting in countries that have implemented them.

Action 12: Requiring Taxpayers to Disclose their Aggressive Tax Planning Arrangements[67]

Mandatory disclosure regimes would oblige taxpayers to provide the tax authorities with early information regarding potentially aggressive or abusive tax planning schemes and permit to identify the promoters and users of those schemes. Such rules increase transparency and address countries' need for more information, while taking into account the compliance costs to taxpayers.

The Code of Conduct should work on proposing EU guidance for implementing this Action, as suggested by the Council in December 2015.

[65] For more details, refer to OECD (2015i)
[66] For more details, refer to OECD (2015n)
[67] For more details, refer to OECD (2015j)

Action 14: Making Dispute Resolution Mechanisms More Effective[68]

Improving dispute resolution mechanisms should allow solving double taxation disputes more efficiently. The measures developed aim at ensuring the effective and timely resolution of treaty-related disputes through the mutual agreement procedure. A certain number of countries have also agreed to introduce mandatory arbitration in their bilateral tax treaties.

The June Action Plan called for further improving the dispute resolution mechanism. The Commission is currently exploring various options for a coordinated EU approach to improve the current situation which is foreseen to be proposed by summer 2016.

Action 15: Developing a Multilateral Instrument[69]

The development of a multilateral instrument would enable countries to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties accordingly. The BEPS Report analyses tax and public law-related issues raised by this approach, which is unprecedented with respect to double tax conventions. Such an approach would allow bilateral tax treaties to reflect the rapidly evolving nature of the global economy.

2.2. Study on Structures of Aggressive Tax Planning and Indicators

The study on Structures of Aggressive Tax Planning and Indicators[70] (hereafter the "ATP Study"), whose results were published in January 2016, provides a useful basis for identifying areas for action in the fight against tax avoidance. It identifies factors that are critical to set up ATP structures and the prevalence of such factors across Member States[71].

The study focuses on national tax rules and practices, and not on treaty-related issues or international principles of allocation of taxing right. All conclusions that can be drawn from this study are therefore bound by its scope, and should not be interpreted as meaning that no action is necessary outside this scope. The study focuses on aggressive tax planning as defined in the Commission Recommendation[72].

In order to find out which factors ("indicators") are critical to the set-up of ATP structures, the study identifies seven structures that are most commonly used by MNEs that engage in aggressive tax planning. From these ATP structures, the study extracts a set of indicators[73]. Below is an overview of the seven model structures:

Type of ATP structure	Brief description[74]
1. Offshore loan ATP structure	The structure takes advantage of situations where interest can be fully deducted in one MS whereas only a small interest spread is being taxed in another MS, with this other MS not imposing withholding tax on the interest paid to an offshore (low taxed) entity.
2. Hybrid loan ATP structure (based on a model identified	The structure takes advantage of the hybrid mismatch in qualification of a financing instrument. It benefits from a deduction of the payment in one MS

[68] For more details, refer to OECD (2015l)
[69] For more details, refer to OECD (2015m)
[70] Ramboll Management Consulting and Corit Advisory (2016)
[71] Tax rules and practices of Member States were examined as of June 2015.
[72] Aggressive Tax Planning is defined as “taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. It may result in double deductions (e.g. the same cost is deducted both in the state of source and residence) and double non-taxation (e.g. income which is not taxed in the source state is exempt in the state of residence)".
[73] For a complete overview of all indicators identified by the ATP Study, refer to Annex A1.
[74] Based on the description provided in pp. 25-50 of the ATP Study

in an OECD report[75])	(e.g. as interest) in combination with no inclusion in another MS (e.g. as tax-free dividend). By inserting an intermediate company resident in a third country, this structure still allows to benefit from a hybrid mismatch.
3. Hybrid entity ATP structure (based on a model identified in an OECD BEPS report [76])	The structure relies on allocating interest costs to a company which is considered a taxable entity in the state of incorporation and as a transparent entity for tax purposes in the state of the participants. The structure takes advantage of the hybrid mismatch in qualification of an entity. It results in a tax deduction for interest in one MS without any inclusion of the payment in the other MS.
4. Interest-free loan ATP structure	The structure takes advantage of a situation where on the one hand deemed interest costs on an interest-free debt can be deducted while there is no income pick-up on the other hand.
5. Patent box ATP structure	The structure benefits from the favourable tax treatment of IP income according to a patent box or other specific tax regime in one MS, while at the same time another MS allows a deduction of royalty payments and does not levy any withholding tax on the outbound royalty payment.
6. Two-tiered IP ATP structure (based on a model identified in an OECD report[77])	The ATP structure takes advantage of mismatches in rules on tax residence of a company incorporated in a MS. Based on such mismatch, the ATP structure benefits from deduction for royalty payments under license- and sub-license-arrangements without any inclusion of the received royalty income (given that the IP has been transferred to a subsidiary incorporated in a MS but tax resident outside of that MS and tax exempt).
7. ATP structure based on IP and cost contribution agreement (based on a model identified in an OECD report[78])	The structure takes advantage of allocating all (or most) of the royalty payments to a company located in a low or no tax jurisdiction, while benefitting from R&D tax credit and deduction of royalties paid in (high tax) MS. This is achieved following a reorganisation and transfer of manufacturing, sales operation and supporting intangibles (IP).

Annex A2 provides an overview of all structures and relevant indicators per structure. It should be noted that some ATP indicators concern tax rules that may pursue valid tax policy objectives.

2.2.1. Tax rules and practices facilitating Aggressive Tax Planning

The crucial role of anti-abuse rules in restricting tax avoidance schemes has been confirmed by the study. The need for action in this area is further supported by the results at Member States level.

CFC rules

The study identifies CFC rules as being critical anti-abuse rules. According to the study, the majority of the model ATP structures would most likely be countered if the Member State in which the parent company is located, applied effective CFC rules. However, half of the Member States do not have CFC rules. The study also states that among the countries that have CFC rules, their scope and application varies.

GAAR

The study examines the absence of a GAAR or of specific anti-abuse rule (SAAR) that would counter the model ATP structures. Almost all Member States (twenty-six) have a GAAR or

[75] OECD (2013a)
[76] OECD (2014)
[77] OECD (2013a)
[78] OECD (2013a)

SAAR[79]. However, the scope of those rules is not such as to counter all identified ATP structures. Rather, existing rules would be able to counter some parts of the structures (i.e. it would make it impossible for a company to play a certain role in the structures if it resident in one the twenty-six Member States). Having an effective GAAR could be relevant for all ATP structures.

Interest limitation rules

The study underlines the scope for tightening anti-abuse rules to counter base erosion by means of financing costs. Twenty-four Member States offer a deductibility of intra-group interest costs, while it is not conditional on the creditor being taxed on the interest income and/or without interest limitation rules (or thin capitalisation rules) or withholding taxes on interest payment[80]. The study considers that rules that limit the deductibility of interest would be capable of undoing or restricting ATP via financing structures (i.e. the first four structures identified by the study).

Hybrid mismatches

The lack of anti-abuse rules is striking in the area of hybrid entities. Twenty-five Member States have been identified as having no rule to counter mismatch in the qualification of a local partnership or company by another state. In eighteen Member States, the tax qualification of a foreign partnership does not follow the qualification of the other state. The lack of anti-abuse rules to counter mismatches in hybrid financial instruments is also identified by the study as an important factor in the ability of MNEs to set up ATP structures. More countries have rules in place to counter mismatches in hybrid financial instruments than in hybrid entities.[81] Rules that counter hybrid mismatches would allow defeating two of the ATP structures identified by the study, i.e. the hybrid loan and hybrid entity ATP structures.

Switch-over rules

Rules that are designed to avoid double taxation are under certain circumstances abused to escape taxation. For example, the tax exemption of dividends received could play a role in an ATP structure, when it is too generously applied and is not accompanied by reservations for other tax avoidance factors. This factor is relevant for the Member State of the parent company in several ATP structures identified by the study. With 15 countries that allow for a generous tax exemption of dividends received, it raises a clear question as to whether those dividends have been taxed in the first place. Switchover rules would usually address such issues.

[79] In other words, the ATP study identified that 26 Member States do not score on indicator 32 (No general or specific anti-avoidance rules to counter the model ATP structures).

[80] Furthermore, if a MS has a withholding tax on interest but exempts or refunds it under certain circumstances, the Member State would be more exposed to being used in an ATP structure if the exemption or refund is granted without any beneficial owner test.

[81] In general, it is important to recall that the main cause for hybrid mismatches is that the tax classification largely depends on different criteria and case law in each Member State. This makes it therefore difficult to say precisely which Member States should score on an indicator. Both sides are equally important and this certainly calls for a coordinated approach. A choice had however to be made in the study on how to define the indicators in order to allow for a review per Member State.

Exit and Capital gains tax rules

The study indicates that the absence of taxation on capital gains upon transfer of IP plays a role in three of the model ATP structures. In case such transfer takes place between two legally distinct entities located in two jurisdictions (as is the case in the three model ATP structures), CFC rules could, among others, be relevant to counter such structures. If however the transfer takes place within a single legal entity (for example a subsidiary and a permanent establishment located in a different jurisdiction) and has the effect of depriving the departure State from its taxing rights over the assets, exit rules would be relevant to address the risk of ATP.

In conclusion, the study shows that there is scope and need for action. There are considerable differences between Member States. The heterogeneity of corporate tax rules across Member States allows companies to exploit mismatches and pay less tax than they ought.

2.2.2. Third-country jurisdictions

The study also highlights the fact that third countries' tax rules may be used to facilitate tax avoidance and the shifting of profits outside the EU. Out of the seven model ATP structures identified by the study, third countries may be involved in six of them[82]. It also identifies which tax rules and practices make a third country more prone to be used in an ATP structure (see Annex A3). Next to the low level of taxation, the existence of preferential treatment for IP or the lack of anti-abuse rules are factors that may prompt the use of third countries in a tax avoidance structure.

The study discusses Overseas Countries and Territories or Outermost Regions of some Member States. Those territories enjoy a special status within or outside the European Union. They may have different tax arrangements or full tax autonomy vis-à-vis their Member State. Those territories may be considered as third-country jurisdictions depending on their interaction with EU law, which differs according to TFEU provisions.

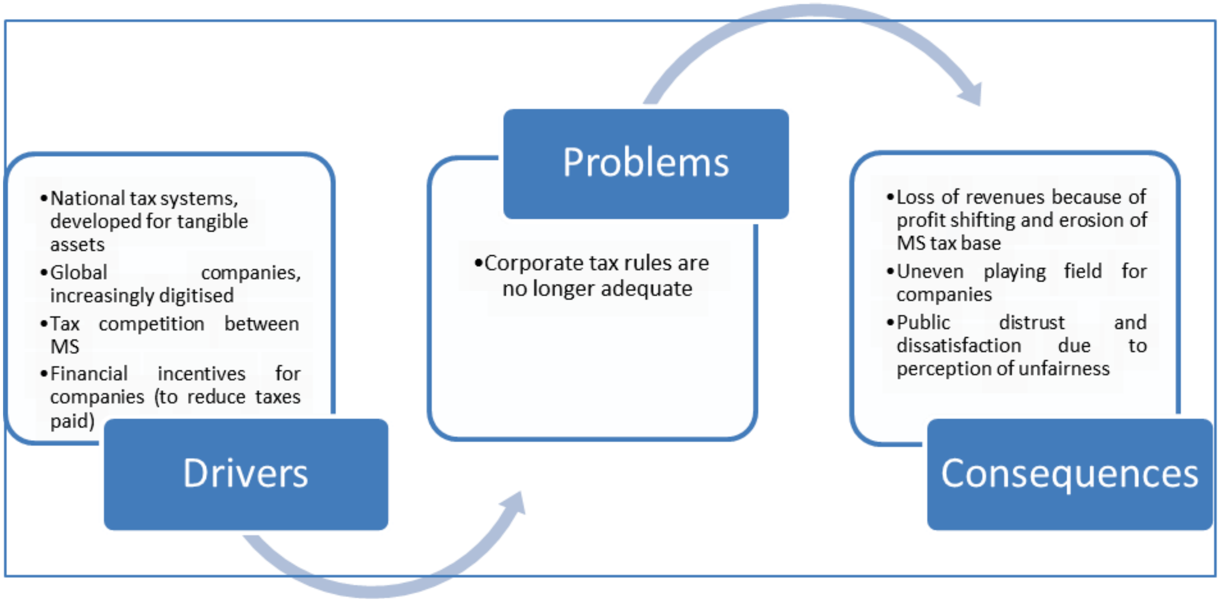
3. Objectives and features of the policy initiative

3.1. General policy objective

The objective of the Anti-Tax Avoidance Package is to enhance the smooth functioning of the Single Market and thereby support the ability of the Single Market to secure sustainable growth, employment and competitiveness. A fair, efficient and growth-friendly corporate taxation is a key element of a strong Single Market. It should be based on the principle that taxes are paid in the country where profits are generated. Today, some multinational companies take advantage of mismatches between national tax systems and exploit loopholes in order to reduce the taxes that they owe. They also exploit the fact that corporate tax rules are no longer well suited to our globalised and digital economy. This means fewer revenues to finance public goods, such as education, infrastructure, etc. or to reduce taxes in other areas. It also affects the level playing field as companies that do pay their fair share of taxes are at a competitive disadvantage. Finally, it threatens the social contract at large. Honest taxpayers (individuals and companies), who shoulder a disproportionate amount of the tax burden, might become less inclined to abide by the rules.

[82] Annex 5 of the ATP Study

Faced with this issue of tax avoidance, some Member States have intensified their efforts to attract MNEs to their own territories, which may create further incentives for companies to shift profits. Others have taken unilateral action to protect their tax bases. While national rules might seem a valuable short term solution for fixing the most pressing issues, the EU has to ensure that an increase in national anti-abuse measures does not undermine the Single Market. The interaction of 28 national corporate tax systems offers, by their very heterogeneity, opportunities for aggressive tax planners to exploit mismatches and loopholes.



The best option is a coordinated approach at EU level. This is necessary in order to safeguard and strengthen the Single Market, in full respect of the fundamental freedoms. The lack of coordination would fragment the Single Market and affect the overall attractiveness and competitiveness of the EU. Furthermore, the absence of such coordination might discourage some Member States to act against tax avoidance in fear of giving a competitive advantage to other Member States. Diverging rules to address tax avoidance, or the absence of such rules in some countries, would indeed affect the level playing field between companies in the EU and the effectiveness of the fight against tax avoidance. Measures taken to address tax avoidance need to be coherent not only within the EU but also in relation to third countries in order to prevent profits from being shifted outside the EU.

Acting now is timely. Member States have called for an EU approach to address corporate tax avoidance. The EP also expects that the Commission takes the lead in developing an EU approach. More broadly, companies, citizens, NGOs expect the issue of tax avoidance to be better addressed, sooner rather than later, to restore fairness and a level playing field. In addition, Member States are reflecting on whether and how to implement the agreed outcome of the BEPS project in their national legislation. The coordination at EU level therefore needs to be shaped as soon as possible.

3.2. Specific policy objectives

Many Member States face problems when determining the taxable profits which derive from economic activity carried out by international companies in their territory. While this development has been especially relevant in the EU due to its unique characteristics such as a single currency area and a Single Market with 28 different tax systems, the overall trend of increased capital mobility and tax competition can also be observed at the global level.

In order to ensure that taxes are paid where the economic activity takes place, and to eliminate profit shifting, it is important to act on various aspects: strengthening domestic tax rules, addressing Tax Treaty issues, enhancing transparency and building a common approach towards third countries.

3.2.1. Strengthening Domestic Tax rules

In order to effectively counter tax avoidance, our proposal puts forward tax rules that ensure that an income cannot go untaxed (or taxed at very low level). While the CCCTB will offer a holistic approach to the problem of tax avoidance, it is important to ensure that in the shorter term, the 28 national corporate rules are coordinated in order to effectively address aggressive tax planning. If there is one weaker link within the EU, it could be exploited by MNEs that seek to avoid taxes. This calls for putting forward rules that would set a common minimum level of protection against tax avoidance in the Single Market. Such rules would address issues that similarly feature in the CCCTB Proposal. The proposed rules should also ensure that the BEPS outcomes are implemented in full compliance with EU law, including the fundamental freedoms as well as fundamental rights as enshrined in the EU Charter of Fundamental Rights. Finally, a Directive will allow for the necessary coordination of all Member States' tax system thereby safeguarding the integrity of the Single Market, limiting distortions and providing legal certainty.

The following tools are being used: deductibility of interest; exit taxation; a switch-over clause; a GAAR; CFC rules; and a framework to tackle hybrid mismatches.

Interest deductibility

Interest costs are deductible for tax purposes in all Member States. Some MNEs have engaged in debt shifting whereby they obtain tax relief for excessive financing costs in high tax jurisdictions, while the interest income is shifted towards low or no tax jurisdictions. Interest limitation rules aim at discouraging such practices. By limiting the amount of interest that can be deducted, it aims at reducing the incentive to shift profits out of the State of origin to low or no tax jurisdictions. The ATP Study shows that four out of seven model ATP structures could be restricted by applying to rules that limit the deductibility of interest.

The interest deductibility rule proposed in the Directive is covered by the OECD/G20 BEPS outcome on action 4. In particular, the Directive foresees a fixed ratio expressed in terms of a taxpayer’s earnings before interest tax depreciation and amortisation (EBITDA), above which net interest expenses cannot be deducted. This is complemented by a group ratio rule. Finally, a safe-harbour provision ensures that companies that have limited net interest expenses are not caught by the rules as these companies are less likely to engage in debt shifting.

It should be noted that the asymmetric tax treatment of debt and equity fuels international debt shifting. Most tax systems give incentives to companies to take on more debt by allowing the deductibility of interest payments while not granting similar treatment to equity. Addressing this tax bias would encourage more equity investments and create a stronger equity base in companies. This view was shared by many respondents to the stakeholders' consultation on the Commission's Green Paper on Building a Capital Market Union.[83] It needs to be ensured

[83] European Commission (2015a)

that it does not open up new tax avoidance strategies. The Commission will examine the possibilities to address debt-equity bias in a new proposal on the CCCTB.

Exit taxation

Tax base erosion in the State of origin may occur when assets which have an underlying but unrealised economic value are moved, without a change of ownership, out of that State. The ATP study identifies that the lack of capital gains tax upon transfer of IP plays a role in three model ATP structures, as it allows the transfer of IP to low or no tax jurisdictions, while paying little or no tax in the country from which the IPs are moved away. While the ATP study focuses on transfers between independent legal entitities, a similar risk could arise in the case of a transfer within a single legal entity where this results in the departure Member State losing its taxing rights over the transferred assets. In such a case, exit taxation would also be relevant.

Exit taxes aim at ensuring that States are in a position to tax the economic value of any capital gain created in their territory even though this gain has not yet been realised at the time of the exit. The OECD/G20 BEPS package did not focus any of its Actions on exit taxation. However, it is worth noting that the Report on Action 6 (Preventing Treaty Abuse) finds that exit taxes are legitimate in the light of what a tax treaty is meant to regulate. The provision of the Directive reflects the Presidency's compromise proposal in the context of discussions on the international aspects of the CCCTB.

The proposed rule on exit taxation would allow taxpayers either to immediately pay the amount of exit tax assessed or defer payment of the amount of tax. The design of the rule ensures compliance with the fundamental freedoms, in particular the freedom of establishment as well as fundamental rights as enshrined in the EU Charter of Fundamental Rights.

Switch-over clause

Taxpayers may take advantage of the fact that foreign income is tax exempt in the state of residence to shift profit. Such exemptions may be provided given the inherent difficulties in giving credit relief for taxes paid abroad. However, they may have the unintended negative effect of facilitating profit shifting.

The ATP study identifies the tax exemption of dividends received as a factor facilitating ATP, especially when this is too generously applied and does not make any reservation for other tax avoidance factors. In several model ATP structures, the ATP study identifies the generous tax exemption of dividends as a factor allowing ATP. Switch-over clauses are commonly used preventing or reducing such practices.

Switch-over rules were not the subject of an OECD/G20 BEPS Action. However, it is noted that they are complementary to CFC rules (discussed under Action 3 of the BEPS) as they serve a similar purpose. In the CCCTB, there were discussions around denying the exemption method in cases where economic double taxation would not arise or would be very limited due to the low level of taxation in the third country. The proposed rules in the Directive build upon discussions on the CCCTB in technical working groups in Council.

The proposed switch-over rules target profit distributions, proceeds from the disposal of shares and permanent establishment profits which are otherwise tax exempt in the EU and originate in third countries. This income will become taxable in the EU, if it has been taxed below a certain level in the third country. A credit is given for the tax paid abroad.

GAAR

The GAAR complements specific anti-abuse rules. It ensures that tax avoidance strategies that were not envisaged by the legislator can be addressed, by granting the authorities the power to deny taxpayers the benefit of ATP arrangements. It was identified in the ATP study as one of the tax rules that could be useful to counter the ATP structures.

While there is no action dedicated to a GAAR in the OECD/G20 BEPS package, it is noteworthy that action 6 (Preventing Treaty abuses) proposes the introduction of a principal purpose test that acts as general anti-abuse rule with respect to tax treaties. The proposed GAAR in the Directive is based on the one presented in the Commission Recommendation on aggressive tax planning[84].

The proposed GAAR provides for the artificiality tests present in the case law. The fundamental freedoms can be legitimately restricted on grounds of tax abuse only to the extent that the taxpayer's arrangements are 'wholly artificial' (non-genuine). The proposed GAAR would apply domestically, intra-EU and internationally.

CFC rules

MNEs with subsidiaries in low-tax jurisdictions may engage in tax planning practices whereby profit is shifted out of the parent company towards those subsidiaries. The effect is to reduce the overall tax liability of the group. CFC rules allow the reattribution of this income of a (low-taxed) controlled subsidiary to its parent company for tax purposes in certain situations. CFC rules therefore can ensure that profits parked in low or no tax countries are effectively taxed. The ATP study considers that CFC rules, if well designed and effective, are critical anti-abuse rules as they could defeat most model ATP structures identified in the study.

CFC rules were discussed in the context of the CCCTB. The proposed CFC rules in the Directive are generally in line[85] with the outcome of Action 3 of the OECD/G20 BEPS project. The proposed Directive covers both intra-EU and extra-EU situations. For intra-EU situations, the rules have to be designed to ensure EU law compliance, and in particular the respect of the fundamental freedoms as well as fundamental rights as enshrined in the EU Charter of Fundamental Rights.

Hybrid mismatches

Hybrid mismatches arise from differences in the legal characterisation of payments (financial instruments) or entities in different jurisdictions. The ATP study identifies two model structures that could be defeated thanks to anti-abuse provisions in this area.

Hybrid mismatches were covered by Action 2 of the OECD/G20 BEPS project. They have also been extensively discussed in the Code of Conduct Group where guidance on hybrid entities and hybrid Permanent Establishments was agreed. Finally, it was also discussed in the context of the CCCTB. The proposed directive includes rules to address hybrid mismatches, which should close the doors to exploiting such mismatches both for entities and transactions.

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[84] European Commission (2012c)

[85] For simplicity reasons, the Directive foresees that all the income of the subsidiary (i.e. the CFC) will be taken into account when the conditions are met. This differs from the OECD/G20 BEPS outcome which allows countries to distinguish between types of incomes.

3.2.2. Addressing Tax Treaties issues

Tax treaties play a very important role in the international framework by encouraging cross-border trade and investment. They allocate taxing rights between the Contracting States and thereby eliminate, or at least alleviate, double taxation. The objective of tax treaties is not however to open avenues for aggressive tax planning or to create opportunities for tax avoidance. Without adequate safeguards they can be exposed and vulnerable to treaty shopping and other abusive strategies. The objective of tax treaties is frustrated (at the expense of public finances) if taxpayers are allowed to claim treaty benefits in situations where those benefits were not intended to be accessible to them. This is also the case if no measures were taken to counter strategies to artificially avoid the permanent establishment status which is an essential concept for allocation taxing rights.

The OECD/G20 examined these issues under Actions 6 and 7. The final report on Action 6 proposes an approach based on different types of safeguards against treaty shopping; the two principal options being (a) a specific "limitation-on-benefits" (LOB) rule and (b) a more general "principal purpose test" (PPT) based anti-abuse rule. While the two may in principle be used simultaneously, in practice they are considered as mutually exclusive alternatives to each other.

It is vital for the good functioning of the Single Market that Member States can operate efficient tax systems and prevent their tax bases from being unduly eroded because of inadvertent non-taxation and abuse. At the same time, it is equally important to strike a proper balance between the public interest of combating abuse and the need to ensure that the solutions to protect tax bases create no undue mismatches and market distortions.

In this regard, the Commission considers LOB clauses[86] to be detrimental to the Single Market and, in particular, Capital Markets Union. The more general anti-avoidance rules based on the PPT, if adopted by Member States, should be adapted to meet the requirements of a Single Market in order for them to be EU law compliant. The principle of equal treatment requires that companies owned by shareholders resident elsewhere in the EU/EEA can benefit from the same advantages derived from the Treaty as those available to companies owned by domestic shareholders.

The final report on BEPS Action 7 aims at making the definition of PE more resilient against the construction of artificial structures to circumvent their application. This definition needs to keep up with developments in an increasingly globalised and digitalised economy.

The conclusion of tax treaties falls within the competence of Member States despite the fact that in the exercise of those competencies, for instance when implementing the minimum standards agreed in the framework of the BEPS Project, they must observe their obligations under EU law. These matters do not lend themselves easily to be addressed in a legally binding instrument such as a Directive, which is why they are included in a Recommendation.

3.2.3. Enhancing transparency

Tax authorities sometimes lack the information that would allow them to better detect tax avoidance strategies of MNEs and act on it. Increasing transparency should strengthen the

[86] LOB rules are designed to curb treaty shopping essentially by denying access to the benefits (e.g. reduced withholding tax rates for dividends, interest and/or royalties) of a tax treaty (between country A and country B), in situations where the beneficial owners (e.g. shareholders) of the recipient of the income (e.g. corporate entity) are not residents in the same country as the recipient of the income (i.e. A or B). They are therefore by definition not easy to reconcile with the objectives of a Single Market.

ability of tax authorities to act against aggressive tax planning. Coupled with the strengthening of the legal framework, this should discourage companies from engaging in such practices.

It is therefore proposed to amend the Directive on administrative cooperation to implement the outcome of the OECD/G20 BEPS Action 13, regarding non public Country-by-Country reporting.

MNEs (with a total consolidated turnover above EUR 750 million) should file country-by-country reports with their tax administration. It will provide an overview of all the constituent entities of the MNE group per tax jurisdiction, as well as an overview of the allocation of income, taxes and business activities by tax jurisdiction. It also includes information on the number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction. The MNEs should submit information to the tax authorities of their jurisdiction of residence. The information would be subsequently shared between tax authorities, on the basis of the existing arrangements on Administrative Cooperation in the field of taxation[87], and in respect for the fundamental rights as enshrined in the EU Charter of Fundamental Rights and in particular the right to protection of personal data, and in line with the applicable data protection laws.

3.2.4. Common EU approach towards third countries

The new External Strategy aims at making the EU approach towards the outside world stronger and more coherent. The European Parliament highlighted the importance of an EU approach to third countries in the fight against tax avoidance. The ATP study shows very clearly that third countries' tax rules may play an important role in the structuring of aggressive tax planning schemes. There have also been several examples of multinational companies shifting their profits towards third countries jurisdictions that offer very low level of taxation. It is therefore important for Member States to act in a coherent way against such practices. This needs to be done in a coordinated manner as the fight against tax avoidance is only as strong as the weakest link. On the other hand, the EU is also aware that third countries may themselves be victims of base erosion and profit shifting. This was stressed at the Third Conference on Financing for Development in July 2015[88] and was at the heart of the debates linked to the adoption of the Addis Ababa Action Agenda[89] and the 2030 Agenda for Sustainable Development[90]. The EU is therefore committed to support them in strengthening their good governance standards for tax purposes.

The external strategy includes the following aspects:

1. re-examining EU good governance criteria;
2. improving tax good governance through agreements with third countries;
3. supporting developing countries in meeting tax good governance standards[91];

[87] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (OJ L 64, 11.3.2011, p. 1).
[88] https://ec.europa.eu/europeaid/sites/devco/files/com_collectmore-spendbetter_20150713_en.pdf
[89] http://www.un.org/esa/ffd/ffd3/wp-content/uploads/sites/2/2015/07/Addis-Ababa-Action-Agenda-Draft-Outcome-Document-7-July-2015.pdf
[90] https://sustainabledevelopment.un.org/post2015/transformingourworld
[91] Particularly in the frame of the EU "Collect more - Spend better" strategy (https://ec.europa.eu/europeaid/sites/devco/files/com_collectmore-spendbetter_20150713_en.pdf) and the Addis tax initiative (http://www.addistaxinitiative.net/).

4. developing a common EU approach to listing and evaluating third countries for tax purposes;
5. and ensuring the use of EU funds supports tax good governance.

With regard to the development of a common EU list of third countries, the Commission envisages a three-step approach. In a first step, the Commission would identify jurisdictions that need to be prioritized for screening at EU level. Prioritization would be based on a ***scoreboard of indicators***[92]. It aims to identify a sub-set of countries which score highly on indicators often associated with ATP and which have strong economic ties with the EU. Being in this subset does not necessarily mean that the country is involved in BEPS-driven activities, but rather provides a starting point for a more detailed assessment. In a second step, on the basis of the outcome of the scoreboard, Member States should decide which jurisdictions are to be assessed against the updated good governance criteria. The assessment will be carried out by the Commission and the Code of Conduct for Business Taxation and it will incorporate a dialogue with the third countries concerned. In a third and last step, Member States should agree on an EU list of problematic tax jurisdictions, based on a recommendation from the Commission.

[92] In annex A4, the "scoreboard of indicators" approach is explained in greater details.

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Annexes

A.1. Overview of ATP indicators[93]

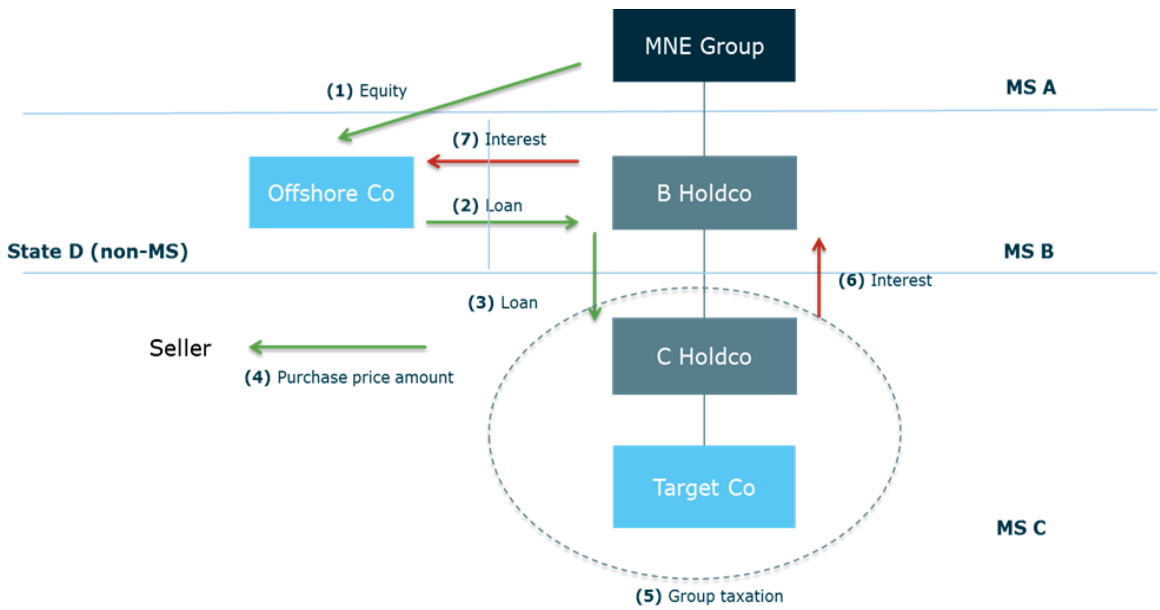
Theme	No.	Subject	Category
Dividends received	**1**	Too generous tax-exemption of dividends received	Passive
Dividends paid	**2**	No withholding tax on dividends paid (absent under domestic law)	Passive
	3	No withholding tax on dividend equivalents (e.g. buy-back of shares)	Passive
	4	No beneficial-owner test for reduction of withholding tax on dividends	Lack of anti-abuse
	5	Tax deduction for dividends paid	Active
Interest income	**6**	Income from certain hybrid instruments non-taxable	Lack of anti-abuse
	7	No deemed income from interest-free loan (non-arm's-length transactions)	Active
Interest costs	**8**	Tax deduction for intra-group interest costs	Passive
	9	Tax deduction does not depend on the tax treatment in the creditor's state	Lack of anti-abuse
	10	Tax deduction allowed for deemed interest costs on interest-free debt	Active
	11	No taxation of benefit from interest-free debt	Lack of anti-abuse
	12	No thin-capitalization rules	Lack of anti-abuse
	13	No interest-limitation rules	Lack of anti-abuse
	14	No withholding tax on interest payments (absent under domestic law)	Passive
	15	No beneficial-owner test for reduction of withholding tax on interest	Lack of anti-abuse
Allowance for equity capital	**16**	Notional interest deduction for share capital	Active
Royalty or other IP income	**17**	Patent box or other preferential tax treatment of income from IP	Active
	18	No taxation of capital gain (fair market value) upon transfer of IP	Passive
Royalty or other IP costs	**19**	Tax deduction for intra-group royalty costs	Passive
	20	No withholding tax on royalty payments (absent according to domestic law)	Passive
	21	No beneficial-owner test for reduction of withholding tax on royalty	Lack of anti-abuse
	22	R&D tax incentive obtainable also for costs that are reimbursed	Passive
Group taxation	**23**	Group taxation with acquisition holding company allowed	Passive
CFC rules	**24**	No CFC rules	Lack of anti-abuse
Foreign legal entities	**25**	Tax qualification of foreign partnership does not follow that of the foreign state	Passive
	26	No rule to counter a mismatch in tax qualification of a domestic partnership between own state and a foreign state	Lack of anti-abuse
	27	No rule to counter a mismatch in tax qualification of a domestic company between own state and a foreign state	Lack of anti-abuse
Tax-free company	**28**	Nil corporate tax rate	Active
	29	Locally incorporated company not tax-resident if management/control is in another state	Active
Ruling practices	**30**	Unilateral ruling on e.g. interest spread or royalty spread can be obtained	Passive
	31	Excess profits rulings	Active
GAAR / SAAR	**32**	No general or specific anti-avoidance rules to counter the model ATP structures	Lack of anti-abuse
Other themes (residual)	**33**	Any other significant ATP indicator to be identified by national tax experts	

[93] Ramboll Management Consulting and Corit Advisory (2016)

A.2. Structures of Aggressive Tax Planning and relevant indicators per structure[94]

The ATP Study identifies seven model ATP Structures. For each of them, the study further identifies a series of indicators (critical tax rules and practices) per country involved in the Structure. This annex presents the seven model ATP structure and indicators that are potentially relevant for Member States[95].

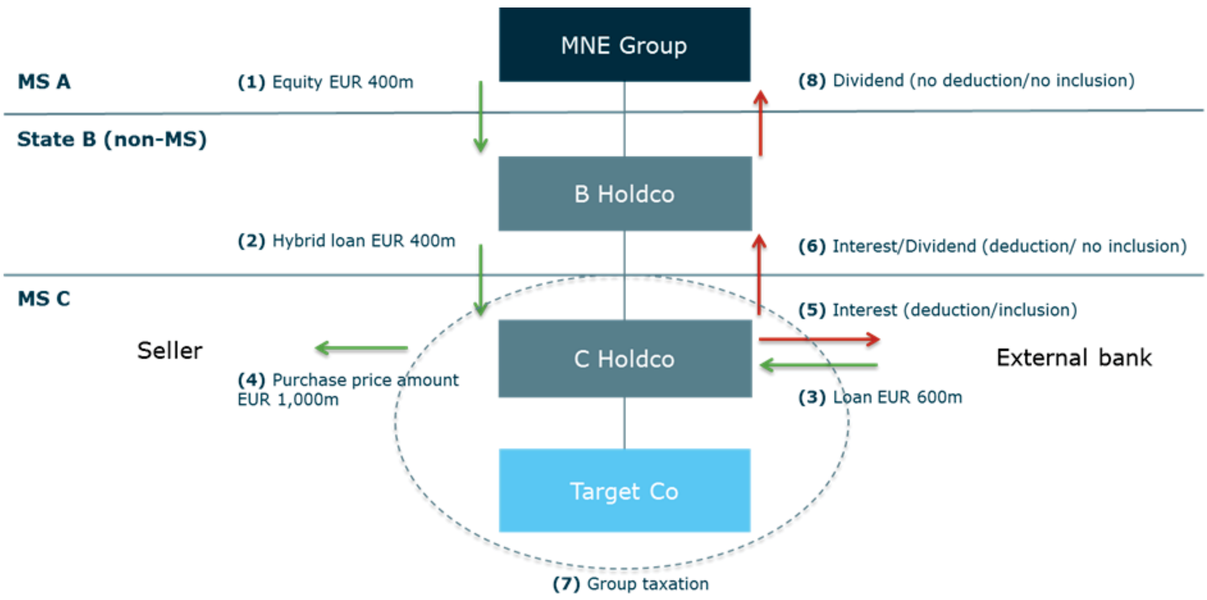
Structure 1: Offshore loan ATP structure



State A		State B		State C	
Relevant indicators		*Relevant indicators*		*Relevant indicators*	
1	Too generous tax-exemption of dividends received.	8	Tax deduction for interest costs.	8	Tax deduction for interest costs.
24	No CFC Rules.	9	Tax deduction does not depend on the tax treatment in the creditor's state.	9	Tax deduction does not depend on the tax treatment in the creditor's state.
		12& 13	No interest-limitation rules and no thin-capitalization rules.	12& 13	No interest-limitation rules and no thin-capitalization rules.
		14 OR 15	No withholding tax on interest payments. No beneficial-owner test for reduction of withholding tax.	14 OR 15	No withholding tax on interest payments. No beneficial-owner test for reduction of withholding tax.
		30	Unilateral ruling on interest spread.	23	Group taxation with acquisition holding company allowed.
		32	No general or specific anti-avoidance rules to counter the model ATP structures.	32	No general or specific anti-avoidance rules to counter the model ATP structures.

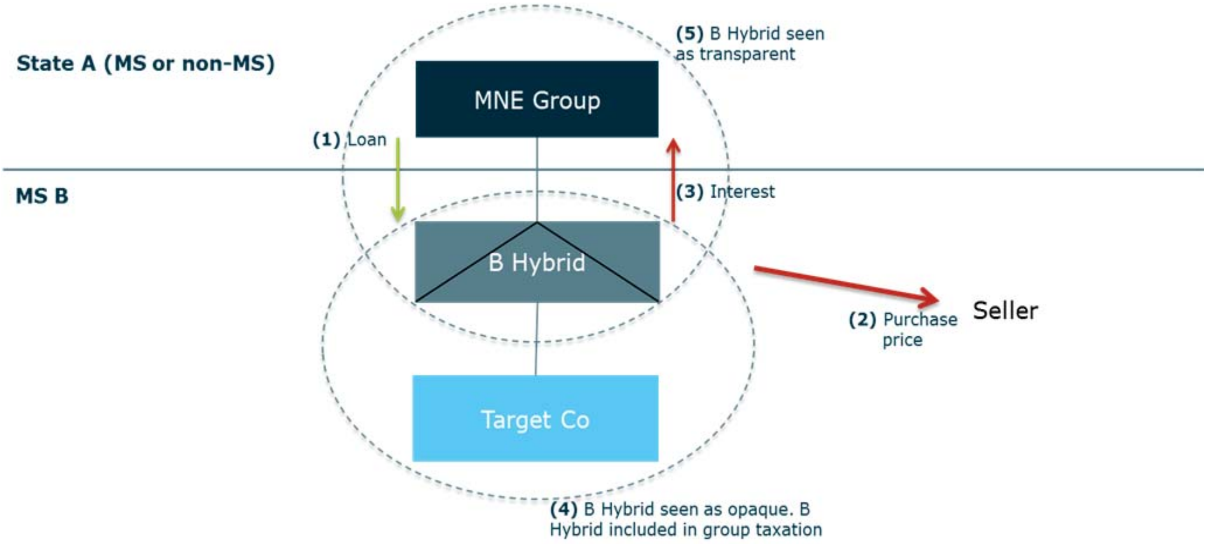
[94] Ramboll Management Consulting and Corit Advisory (2016).
[95] The indicators relative to countries that are necessarily outside of the EU are not presented per structure.

Structure 2: Hybrid loan ATP structure



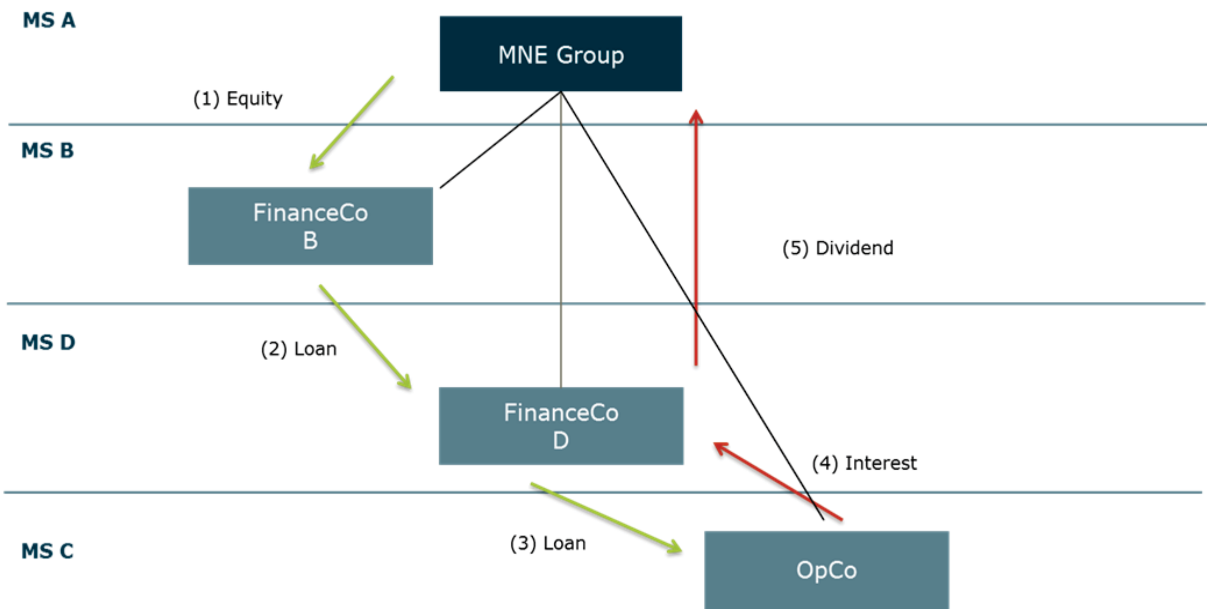
State A		**State C**	
Relevant indicators		*Relevant indicators*	
1	Too generous tax-exemption of dividends received.	8	Tax deduction for interest costs.
24	No CFC Rules.	9	Tax deduction does not depend on the tax treatment in the creditor's state.
		12& 13	No interest-limitation rules and no thin-capitalization rules.
		14 OR 15	No withholding tax on interest payments. No beneficial-owner test for reduction of withholding tax.
		23	Group taxation with acquisition holding company allowed.
		32	No general or specific anti-avoidance rules to counter the model ATP structures.

Structure 3 - Hybrid entity ATP structure



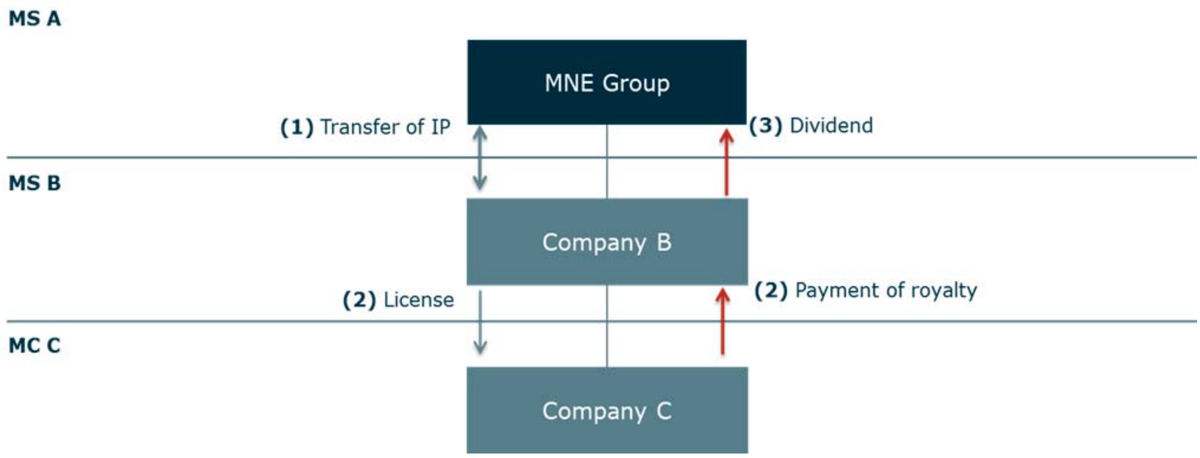
State A		State B	
Relevant indicators		*Relevant indicators*	
25	Tax qualification of the foreign entity does not follow that of the foreign state.	8	Tax deduction for interest costs.
32	No general or specific anti-avoidance rules to counter the model ATP structures.	9	Tax deduction does not depend on the tax treatment in the creditor's state.
		12& 13	No interest-limitation rules and no thin-capitalization rules.
		14	No withholding tax on interest payments.
		23	Group taxation with acquisition holding company allowed.
		27	No rule to counter a qualification mismatch of a local company.
		32	No general or specific anti-avoidance rules to counter the model ATP structures.

Structure 4 - Interest-free loan ATP structure



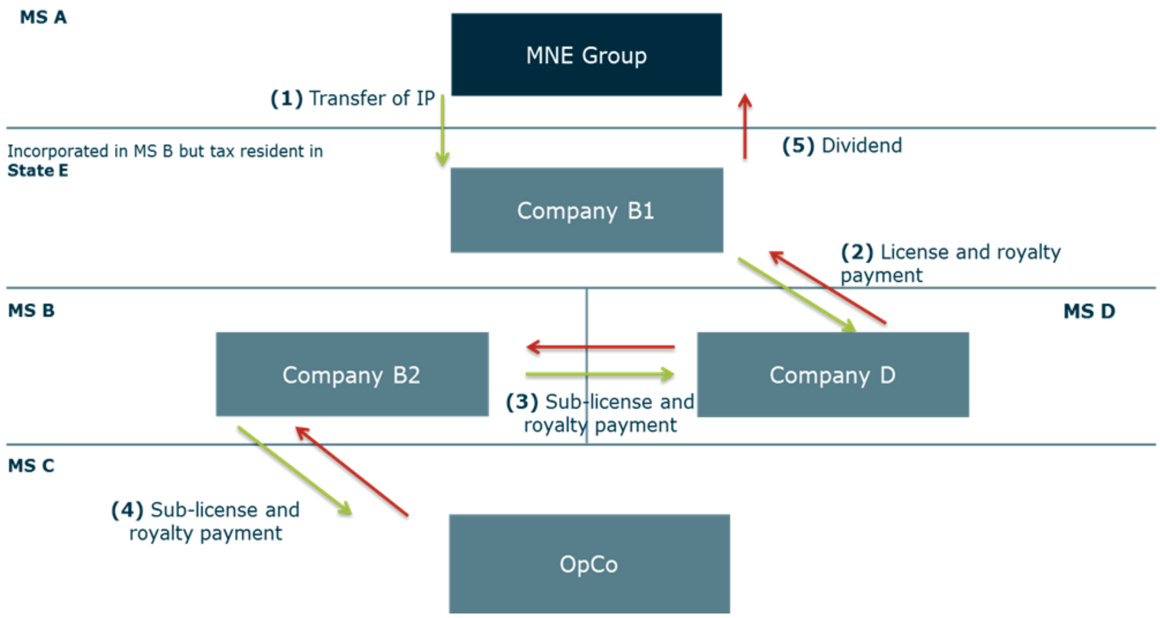
State A		State B		State C		State D	
Relevant indicators		*Relevant indicators*		*Relevant indicators*		*Relevant indicators*	
1	Too generous tax-exemption of dividends received.	7	No deemed income from interest-free loan (non-arm's-length transactions).	8	Tax deduction for interest costs.	2	No withholding tax on dividends paid.
24	No CFC Rules.			12& 13	No interest-limitation rules and no thin-capitalization rules.	8	Tax deduction for interest costs.
				14	No withholding tax on interest payments.	10	Interest deduction allowed for deemed interest costs on interest-free debt.
				15	No beneficial-owner test for reduction of withholding tax on interest.	11	No taxation of benefit from interest-free debt.
				32	No general or specific anti-avoidance rules to counter the model ATP structures.	12& 13	No interest-limitation rules and no thin-capitalization rules.
						32	No general or specific anti-avoidance rules to counter the model ATP structures.

Structure 5 - Patent box ATP structure



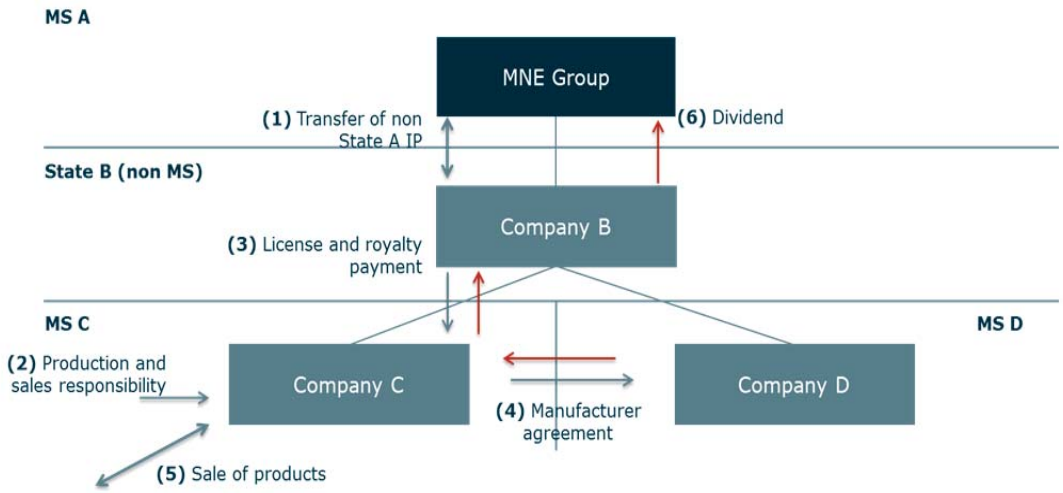
State A		State B		State C	
Relevant indicators		*Relevant indicators*		*Relevant indicators*	
1	Too generous tax-exemption of dividends received.	2	No withholding tax on dividends paid.	19	Tax deduction for royalty costs.
18	No taxation of capital gain (fair market value) upon disposal of IP.	17	Patent box or other preferential tax treatment of income from IP.	20	No withholding tax on royalty payments.
24	No CFC Rules.			21	No beneficial-owner test for reduction of withholding tax.
				32	No general or specific anti-avoidance rules to counter the model ATP structures.

Structure 6 - Two-tiered IP ATP structure



State A		State B		State C		State D	
Relevant indicators		*Relevant indicators*		*Relevant indicators*		*Relevant indicators*	
1	Too generous tax-exemption of dividends received.	2	No withholding tax on dividends paid.	19	Tax deduction for royalty costs.	19	Tax deduction for royalty costs.
18	No taxation of capital gain (fair market value) upon disposal of IP.	19	Tax deduction for royalty costs.	20	No withholding tax on royalty payments.	20	No withholding tax on royalty payments.
24	No CFC Rules.	20	No withholding tax on royalty payments.	21	No beneficial-owner test for reduction of withholding tax.	21	No beneficial-owner test for reduction of withholding tax.
		21	No beneficial-owner test for reduction of withholding tax.	32	No general or specific anti-avoidance rules to counter the model ATP structures.	32	No general or specific anti-avoidance rules to counter the model ATP structures.
		29	Locally incorporated company not tax-resident if management/control is situated in another state.				
		32	No general or specific anti-avoidance rules to counter the model ATP structures.				

Structure 7: ATP structure based on IP and cost-contribution agreements



State A		State C	
Relevant indicators		*Relevant indicators*	
1	Too generous tax-exemption of dividends received.	19	Tax deduction for royalty costs.
18	No taxation of capital gain (fair market value) upon disposal of IP.	20	No withholding tax on royalty payments.
22	R&D tax incentive obtainable also for costs that are reimbursed.	30	Unilateral ruling on earnings spread.
24	No CFC Rules.	32	No general or specific anti-avoidance rules to counter the model ATP structures.

A.3. Overview of indicators that render a third country's legislation more prone to be used in an ATP structure[96]

Theme		No.	Subject	Category
Dividends	**Received**	**1**	Too generous tax-exemption of dividends received	Passive
	Paid	**2**	No withholding tax on dividends paid (absent under domestic law)	Passive
		3	No withholding tax on dividend equivalents (e.g. buy-back of shares)	Passive
Interest	**Income**	**6**	Income from certain hybrid instruments non-taxable	Lack of anti-abuse
		7	No deemed income from interest-free loan (non-arm's-length transactions)	Active
	Cost	**8**	Tax deduction for intra-group interest costs	Passive
		9	Tax deduction does not depend on the tax treatment in the creditor's state	Lack of anti-abuse
		14	No withholding tax on interest payments (absent under domestic law)	Passive
Royalty or other IP income		**17**	Patent box or other preferential tax treatment of income from IP	Active
Royalty or other IP costs		**19**	Tax deduction for intra-group royalty costs	Passive
		20	No withholding tax on royalty payments (absent according to domestic law)	Passive
CFC rules		**24**	No CFC rules	Lack of anti-abuse
Foreign legal entities		**25**	Tax qualification of foreign partnership does not follow that of the foreign state	Passive
		26	No rule to counter a mismatch in tax qualification of a domestic partnership between own state and a foreign state	Lack of anti-abuse
		27	No rule to counter a mismatch in tax qualification of a domestic company between own state and a foreign state	Lack of anti-abuse
Tax-free company		**28**	Nil corporate tax rate	Active
		29	Locally incorporated company not tax-resident if management/control is in another state	Active
GAAR / SAAR		**32**	No general or specific anti-avoidance rules to counter the model ATP structures	Lack of anti-abuse

[96] Ramboll Management Consulting and Corit Advisory (2016)

A.4. "Scoreboard of indicators" to identify third countries subject to further evaluation

A.4.1. General approach

Tax avoidance can occur through three main channels (debt shifting, transfer pricing and location of intangible assets) and often involves specific financial constructions, often located offshore. Third countries may be used in some type of aggressive tax planning structures but not in others[97]. Furthermore, tax avoidance is a complex and multi-faceted phenomenon, which needs to be looked at from various angles. It is therefore important to rely on a range of indicators that are able to reflect various types of structures.

It is proposed to consider three dimensions:

- Financial importance: Third-country jurisdictions that are used in ATP structures should record (abnormally) high financial flows (such as interest income or royalty income that allow artificially shifting profit, or through the establishment of numerous foreign-owned subsidiaries for tax purposes). They are also likely to be specialised in trade in financial services to non-residents.[98] This category of indicators will therefore focus on the financial "symptoms" associated to ATP, both in absolute terms (the biggest financial centres), but also relative to the size of real economic activity.

- Importance of economic ties with the EU: This category of indicators aims to focus attention on those jurisdictions with which the EU has strong economic links.

- Institutional and legal factors: This category of indicators will reflect factors that facilitate or are necessary for engaging in ATP. The economic literature identifies as a main and obvious characteristic of a tax haven its very low rate of business taxes. Other findings relate to good governance and structure of the tax systems.[99] The ATP Study identifies additional indicators such as the absence of withholding taxes on interest, royalties or dividends. It also identifies which tax rules and/or practices those offshore jurisdictions would need to have in order to facilitate the setup of an aggressive tax planning structure.

It is important to stress that each potential single indicator cannot in itself suffice to draw conclusions on whether a country should be prioritised for screening. For example, most indicators relative to the "financial importance" of a jurisdiction do not allow to disentangle BEPS-driven activities from real economic activities. Similarly, it should be stressed that some indicators, for example in the category of "institutional and legal factors", may very well serve a positive function in the organisation of the country but are "abused" by aggressive tax planners. This is also true for the other categories of indicators. Therefore one needs to look at a range of indicators before reaching any conclusion.

Finally, the preselection of a third country does not rest on the requirement to have all indicators "in the red". On the contrary it is only necessary for a minimum of warning signals to be on. The aim of the information gathering exercise in the scoreboard is to enable a **pre-selection**. Therefore the adverse consequences of forgetting a potential jurisdiction that should be screened ("*false negative*") are much more important than the ones linked to the preselection of jurisdictions that only stand out for perfectly legitimate reasons ("*false*

[97] For instance, the ATP study identifies how offshore jurisdictions's tax rules could be used in various structures of aggressive tax planning (see above section 2.2.1).
[98] Zoromé, 2007
[99] Dharmapala and Hines (2009); Konrad and Stolper (2015).

positive"), as there will be further checks and assessments carried out in the rest of the process.

A.4.2. Data selection and limitations

An indicative list of indicators which might be among those considered for the first step screening can be found in the table below.

Category	**Examples of proposed indicators and potential data sources**
Financial importance	Measuring financial importance, and comparing it to economic activity: - International investment position (IIP) - IIP expressed as a percentage of GDP and other economic variables - Foreign direct investment (FDI) flows - inwards and outward - FDI flows expressed as a percentage of GDP and other economic variables *Sources*: UNCTAD database, IMF (coordinated direct investment survey (CDIS), coordinated portfolio indicators (CPIS)), BIS
Economic ties with the EU	- Trade, trade in (financial) services from and to EU-28 from all partner countries - FDI, FDI income and FDI position from and to EU-28 from all partner countries. - Number and characteristics of foreign affiliates *Sources:* Eurostat Balance of Payment data, Eurostat FATS
Institutional and legal factors	- Good governance indicators[100] (*source*: World Governance Indicators) - Information about tax revenues (*source*: ICTD, Information Centre on development and taxation, OECD) - Specific features of tax systems, like the absence of withholding taxes on interest royalties or dividends, low corporate income tax rate - Transparency indicators: including information exchange, possible anti-money laundering [if data are available], compliance ratings on access to tax information (OECD Tax transparency Forum). - Information, rankings and indices compiled by other sources: Illicit Financial Flows (IFF)[101], Financial Secrecy Index (FSI)[102] … …

The preliminary choice of the indicators has been guided by their relevance in identifying jurisdictions that merit further screening, and was focussed on elements for which information is available in a comprehensive and comparable manner. The chosen economic indicators are

[100] Some of the World Governance Indicators could be used, which include voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption.
[101] Kar D. and J. Spanjers (2014)
[102] The recently released financial secrecy index (FSI) identified 15 qualitative indicators that indicate non-transparency and can be considered as pre-conditions for facilitating tax evasion (but also possibly other activities such as money laundering). See Tax Justice Network, 2015, http://www.financialsecrecyindex.com/index.php/introduction

all based on macro-data for which the coverage was found to be more comprehensive and comparable than that for micro data (i.e. at company level or from tax receipts)[103].

Coverage may differ per country and per indicator, with some risk of sampling bias, if the analysis would be limited to countries for which the dataset is complete. The use of a scoreboard with possible missing values already alleviates that risk in comparison with the use of a single number or formula. Furthermore, as missing data can occur for spurious reasons, but may also be an indication of secrecy (or of insufficient administrative capacity), jurisdictions for which some or most of the indicators are missing cannot simply be ignored from the analysis. On the contrary, those jurisdictions will be specifically indicated for further consideration.

With respect to the choice of which data vintage to use, there is a trade-off between using the most up-to-date indicators, and being misled by one particular data point corresponding to specific circumstances, in particular for very volatile data. Using averages of recent years is an alternative – this would also reflect more structural characteristics of countries.[104]

A.4.3 Use of the scoreboard for setting priorities for further assessment

At the level of each indicator taken separately, ranking countries per indicator is obviously the best way to allow for later prioritisation. ([105]). This will be done for each indicator and for all jurisdictions, but jurisdictions with missing values will be marked separately.

In a second step, when aggregating or selecting among closely related indicators, recourse is made to the general guiding principle explained above: "false negatives" - third countries not being preselected while they would deserve to be further scrutinised - should be avoided. To avoid this risk of "false negatives", it is therefore suggested to take only the "worst" indicator (and not the average indicator for instance). In other words, the indicator reflecting the highest risk to be used for ATP purposes would be retained. To give an example related to the selection of the relevant time period: One indicator, such as the relative importance of FDI flows, will be ranked independently over several different time periods, corresponding to several different variations of the data: one for each of the last years and also the average of recent (10) years. Out of those rankings, the scoreboard will only reflect, for each jurisdiction, the one ranking based on the most suspicious outcome (in this case the highest of the rankings, which will be the one based on the time period, or on the average, for which the relative importance of FDI flows was the highest compared to other jurisdictions).

Finally, and for reasons linked to the phenomenon we try to apprehend, but also given the possible data limitations of which the most important is incomplete coverage, no rigid

[103] In the framework of the OECD/G20 BEPS Action 11 (OECD (2015i)), many different indicators (based both on micro- and macro-data) were reviewed to identify the scale and economic impact of BEPS, to track changes in BEPS over time and to monitor the effectiveness of measures implemented to reduce BEPS. Existing data sources were also examined. In this context, it is noted that, while firm-level data are needed for a better analysis of BEPS, current sources suffer among others of a sampling bias (e.g. too Eurocentric, weak coverage of low-income countries).

[104] It should be recalled that economic indicators tend to be released with a time-lag and this is even more the case for "softer" indicators gathered through surveys or by combining several strands of data. In addition it should be emphasized that the indicators would inevitably reflect reforms undertaken by countries to address ATP with a delay because of inertia both in economic structures and in perception.

[105] More refined indicators like implicit percentiles could also be used, as they would also allow reflecting the distance between countries. A simple ranking would indeed not show if countries ranked for instance first and second have nearly the same values, or if they differ by a full order of magnitude (while estimated percentiles would give such an indication). However, given that the main purpose of the scoreboard is preselection, this additional information was not deemed essential at this stage.

combination of the potential strands of indicators into a single composite indicator is currently foreseen. In addition to the necessity of perfect data coverage, this kind of methodology obviously entails numerous choices and selections, some of which are unavoidably of an arbitrary nature, and therefore predictably open to criticism. Rather, the exercise is one of gathering multi-faceted information along the three dimensions outlined above. This comes in contrast to the approach taken elsewhere, for instance by the Tax justice network in the recent release of its "financial secrecy index" which builds numerous indicators into a single number, allowing for a single listing of a total of around 100 jurisdictions but for a different objective, and a slightly narrower scope.[106] [107]

Finally, the scoreboard is seen as a tool for priority setting and therefore does not formally set a limit on the number of jurisdictions subject to further scrutiny.

[106] http://www.financialsecrecyindex.com/introduction/fsi-2015-results

[107] Tax justice network, 2015, Financial secrecy index 2015 Methodology, 101p, version dated 16.10.2015. Up to 204 criteria covering information on the legal, administrative, regulatory, and tax structures of the chosen jurisdictions have been surveyed. About 46 of the 204 criteria employed are then used to construct 15 different key secrecy indicators (KFSIs). The 15 indicators cover 4 areas: (a) knowledge of beneficial ownership, (b) corporate transparency, (c) efficiency of tax and financial regulations, and (d) international standards and cooperation. Missing information is considered an indication of secrecy. The 15 key qualitative indicators are themselves aggregated into a single one and then finally weighted through the use of the country's absolute share in the world total trade of financial services; this gives a single ranking, which is subject to the choices made regarding indicator selection, aggregation and weighing.

A.5. OECD BEPS Actions and corresponding EU Actions

	OECD BEPS	EU ACTION
Action 1: Digital Economy	**Direct Tax**: The digital economy is the whole economy, so ring fenced solutions are not appropriate. OECD BEPS actions in general should address risks posed by digital economy. **VAT**: VAT should be paid in country of consumer and States should provide simplified systems for businesses to pay it.	**Direct Tax**: EU agrees with OECD assessment that no special action needed. Situation will be monitored to see if general anti-avoidance measures are sufficient to address digital risks. **VAT**: VAT is paid in country of consumer for e-commerce sales. Simplified payment system in place for certain digital services since 2015, which the Commission will propose to extend to tangible goods in 2016 (MOSS).
Action 2: Hybrid Mismatch Arrangements	Specific recommendations to link the tax treatment of an instrument or entity in one country with the tax treatment in another, to prevent mismatches.	ATA Directive includes a provision to address hybrid mismatches.
Action 3: Controlled Foreign Companies (CFCs)	Best practice recommendations for implementing CFC rules.	ATA Directive includes provisions on CFC rules, for within the EU and externally.
Action 4: Interest Limitation	Best practice recommendations on limiting a company's or group's net interest deductions.	ATA Directive includes provisions to limit interest deductions, for situations within the EU and externally.

Action 5: Harmful Tax Practices **Action 5: Harmful Tax Practices**	Tax rulings: Mandatory spontaneous exchange of relevant information. Patent Boxes: Agreement on "Nexus Approach" to link tax benefits from preferential regimes for IP to the underlying economic activity.	Tax rulings: Mandatory automatic exchange of information on all cross-border rulings and APAs from 2017. Patent Boxes: Member States agreed to ensure that their Patent Boxes are in line with the nexus approach (Code of Conduct Group, 2014).
Action 6: Treaty Abuse	Anti-abuse provisions, including a minimum standard against treaty shopping, to be included in tax treaties. Choice of either Limitation of Benefits (LOB) or Principle Purpose Test (PPT) or a combination of both.	ATA Recommendation on Tax Treaties encourages Member States to use an EU-compatible PPT approach. LOB clauses are less easily adapted to the needs of the Single Market.
Action 7: Permanent Establishment	Definition of Permanent Establishment (PE) is adapted in Model Tax Convention, to prevent companies from artificially avoiding having a taxable presence.	ATA Recommendation encourages MSs to use the amended OECD approach.
Actions 8 -10: Transfer Pricing **Intangibles** **Risk and Capital** **High Risk Transaction**	Arm's Length Principle and Comparability Analysis confirmed as pillars of Transfer Pricing. More robust framework for implementing this standard.	Joint Transfer Pricing Forum (JTPF) working on EU approach to implementing BEPS conclusions. Work includes looking at more economic analysis in TP, better use of companies' internal systems, and improving TP administration.
Action 11: Measuring and monitoring BEPS	The OECD aims to publish new statistics on corporate taxation and the scope and revenue impact of BEPS.	EU study underway on the impact of some types of aggressive tax planning on Member States' effective tax rates. The tax rates are based on

		a representative firm and calculated by using a neoclassical investment model.
Action 12: Disclosure of Aggressive Tax Planning	Recommendation to introduce rules requiring mandatory disclosure of aggressive or abusive transactions, structures or arrangements.	To be discussed in the Code of Conduct. The Commission will keep the issue under review, as part of its tax transparency agenda.
Action 13: Transfer Pricing documentation and Country-by-Country Reporting	MNEs required to file an annual Country-by-Country report (CbCR) to tax administrations on key financial data, as well as a master file and local file. Information for tax authorities only – not public CbCR.	ATA Package proposes legally binding requirement for Member States to implement the OECD CbCR provisions. EU-TPD, broadly in line with the master file and the local file, but to be reviewed to take into account the conclusions of the BEPS project. Work ongoing on feasibility of public CbCR in the EU.
Action 14: Dispute Resolution	G20/OECD countries agreed to measures to reduce uncertainty and unintended double taxation for businesses, along with a timely and effective resolution of disputes in this area. A number of countries have committed to a mandatory binding arbitration process.	In 2016, the Commission will propose measures to improve dispute resolution within the EU, as foreseen in the June 2015 Action Plan.
Action 15: Multilateral Instrument to modify tax treaties	Interested countries have agreed to use a multilateral instrument to amend their tax treaties, in order to integrate BEPS related measures where necessary	ATA Recommendation sets out the Commission's views on Treaty related issues and their compatibility with EU law, which MSs should consider in their negotiations on the Multilateral Instrument.