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Subject:	Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)

EXPLANATORY NOTES

This document explains the proposed changes to the Common Consolidated Corporate Tax Base (CCCTB) proposal as reflected in the Italian Presidency Compromise text set out in doc. 15756/14 FISC 197.

ANNEX

Preliminary comments

CCCTB & BEPS

As known, the OECD is currently working, with the support of the G20, to develop recommendations aimed at tackling the phenomenon commonly referred to as Base Erosion and Profit Shifting (BEPS). In July 2013 the OECD launched an Action Plan on BEPS, identifying 15 specific actions which are scheduled to be finalized in three phases: September 2014, September 2015 and December 2015.

As BEPS issues are also relevant within the EU, the Italian Presidency has been promoting, with the support of the Member States, an EU/BEPS work programme. This has been done, *inter alia*, by orientating discussions on the main EU initiative in the corporate tax area towards BEPS objectives and results, with a view to ensuring maximum consistency between EU and OECD work.

The CCCTB proposal is an important part of this work programme given that both this proposal and the BEPS project aim at achieving more coherence of the corporate tax systems, respectively within the EU and at global level. Therefore the Italian Presidency has focused its work on the CCCTB proposal mainly on the international aspects related to the tax base as well as on certain aspects of the CCCTB proposal which are closely linked to the OECD BEPS work.

Content of the Italian Presidency compromise text

The Italian Presidency overall compromise text covers the Articles related to the tax base, the Articles dealing with international and BEPS-related aspects and some Articles concerning the financial sector.

The Articles related to the tax base (which have not been discussed during the Italian Presidency) have been taken from compromise texts drafted by previous Presidencies (notably the Danish, Lithuanian and Hellenic Presidencies, as relevant), without introducing any changes.

The Articles on international and BEPS-related aspects as well as certain Articles concerning the financial sector (on which the Italian Presidency has focused its work) reflect the outcome of the Working Party on Tax Questions (WPTQ) meetings held during the Italian Presidency where those Articles were discussed; they have been complemented, in some cases, by suggestions made by the Italian Presidency.

The Presidency intends to devote the discussion at the WPTQ meeting of 24 November only on the Articles on which it has focused its work.

CHAPTER I
SCOPE

Articles from 1 to 3 replicate the wording of the Commission proposal.

CHAPTER II
FUNDAMENTAL CONCEPTS

Article 4 replicates the wording of the Commission proposal.

Article 5

Permanent establishment

General comments

The current definition of permanent establishment (PE) laid down in Article 5 of the CCCTB proposal essentially replicates the wording of Article 5 of the OECD Model Tax Convention.

However, as known, the definition of PE is one of the issues under examination in the context of the OECD BEPS project. The BEPS Report and the Action Plan recognize that the current definition of PE must be updated by changing Article 5 of the OECD Model Tax Convention. As required by Action 7, such change must mainly address two topics: the use of commissionaire arrangements and the specific activities exemptions.

The outcome of the work being carried on at OECD level is expected by September 2015.

The importance of the efforts made by the OECD on this issue is also highlighted in the Report of the Commission Experts Group on the taxation of digital economy of 28 May 2014.

Paragraph 3

Taking into consideration the continuous development of new models of business which render the traditional economy obsolete, the Italian Presidency proposes to introduce, in paragraph 3 of Article 5, a condition according to which, in order to avoid the existence of a permanent establishment, the activities listed therein must effectively be of auxiliary or preparatory character.

The proposed wording has been slightly amended so as to clarify that the burden of proof lies with the taxpayer, who can claim the absence of a permanent establishment only by demonstrating the residual importance of the activities carried on at a fixed place ("*if the taxpayer demonstrates that such activities are or, in case of point f), the overall activity is of auxiliary or preparatory character*").

Paragraphs 4 and 5

In many cases commissionaire structures are put in place primarily in order to erode the taxable base of the State where the sales took place.

The formal conclusion of contracts, spending the name of the taxpayer, should not be required anymore as a condition for the existence of a permanent establishment and attention should be paid to the nature of the relationship (dependence/independence).

Given the need to focus on the substance of the relationship between the agent and the principal, the Presidency suggests to replace the sentence in paragraph 4 "*concludes contract in the name of the taxpayer*" with "*concludes in a State contracts which, as a result of a legal relationship with the taxpayer, are on the account and risk of the taxpayer*".

The proposed formulation clarifies that, to have a permanent establishment, the contracts concluded by the agent must be on account and at risk of the taxpayer by virtue of legal (not only economic) relationship between the person and the intermediary.

As a consequence of the changes to paragraph 4, paragraph 5 has also been modified to delete each reference to brokers and general commission agents, thereby preventing the argument that such persons are “deemed” to be independent agents. Instead of the reference to specific contractual relationships, a generic reference to the "independent agent" is provided.

CHAPTER III
OPTING FOR THE SYSTEM PROVIDED FOR BY THIS DIRECTIVE

CHAPTER IV
CALCULATION OF THE TAX BASE

Articles 9 and 10 replicate the wording of the Lithuanian Presidency compromise text.

Article 11

Exempt revenues

Letters c) and d)

As concerns profit from distribution (letter c)) and proceeds from disposal of shares (letter d), the Italian Presidency suggests introducing the requirement of a minimum holding of 10 per cent, in order to ensure that the exemption is granted only to participations representing a minimum interest in the capital of the participated entity.

Given the comments made by a number of delegations at the WPTQ meeting of 3 July 2014, the compromise text has been slightly amended so that the threshold of 10 per cent can alternatively refer to the holding of capital as well as of the voting rights.

A 10 per cent threshold seems to be consistent with the minimum holding provided for by Directive 2011/96/EU (Parent-Subsidiary Directive).

Furthermore, in order to grant the participation exemption regime, the Italian Presidency proposes to include a minimum holding period of twelve months preceding the distribution or the disposal. This means that the participation exemption regime does not apply to financial instruments (including shares) held for trading purposes. This provision is in line with the Parent-Subsidiary Directive which provides for an optional minimum holding period not exceeding 24 months. In case the participation is held for less than twelve months, Article 23 would apply. As a consequence, the participation would be qualified as held for trading and the relevant income would not be exempt from taxation.

In letters c) and d) it is clarified that the exemption does not apply to:

- profit distribution from shares held for trading in accordance with paragraph 3 of Article 23 and from shares held by life insurance undertakings in accordance with Article 30 (b);
- disposal of shares held for trading in accordance with paragraph 3 of Article 23 and of shares held by life insurance undertakings in accordance with Article 30 (b).

Articles 12 and 13

Articles 12 and 13 replicate the wording of the Lithuanian Presidency compromise text.

Article 14 a
Interest limitation rule

General comments

The Italian Presidency is of the view that an interest limitation rule should not be limited to "related parties". This approach, which was firstly proposed by the Danish Presidency and subsequently by the Hellenic Presidency, collected a spread consensus by the Member States.

The work on interest limitation is strictly connected to the BEPS project, with particular reference to Action 4 of the BEPS Action Plan. The Presidency believes that observations developed by the OECD should be taken into account in developing an interest limitation rule to be included in the CCCTB Directive.

Paragraph 1

The first paragraph provides for a general rule according to which borrowing costs can always be deducted to the extent the taxpayer receives interest or other taxable revenues from financial assets.

Paragraph 2

The agreement on what is meant by the term "interest" is a major issue. Any definition needs to be sufficiently targeted to address the specific risks that the interest limitation rule is intended to tackle, without limiting deductions for other unrelated categories of expense. At the same time, a definition should be wide enough to prevent an entity circumventing the rule by converting interest into something that would not be caught.

Given the results of the discussion held at the WPTQ meeting of 17 September 2014, the Presidency suggests to include in Article 14 a) the definition of "borrowing costs" which was contained in the Danish Presidency compromise text.

This proposal allows to include in the definition of borrowing costs even expenses that are not strictly intended as interests in order to avoid groups re-structuring loans into other forms resulting in deductible costs.

Paragraph 3

The Italian proposal is an EBITDA-based rule. The Presidency is of the view that EBITDA may be a more appropriate measure in determining the level of debt that an entity can support and so the level of interest expense that should be allowed.

The proposed provision allows a deduction of exceeding interest in the current tax year up to [30] percent of the gross operating profit of the company or up to EUR 1 million (safe harbour threshold), whichever is higher.

Paragraphs 4 and 5

In order to allow the deductibility of borrowing costs exceeding the threshold of paragraph 3, the proposal provides for a carry forward of the gross of the operating profit of a tax year which is not fully absorbed by the borrowing costs incurred by the taxpayer in that or previous tax years.

Furthermore, it is provided for that borrowing costs which cannot be deducted in the current tax year shall be deductible up to 30 percent of the gross operating profit in subsequent tax years, in the same way as the borrowing costs for those years.

Paragraph 6

The proposed provision provides for a special treatment for the financial sector. In particular, paragraph 6 of Article 14a excludes the application of the interest limitation rule in case of financial institutions and insurance undertakings. Such a provision substantially replicates paragraph 5 of Article 14a in the version proposed by the Hellenic Presidency.

Articles 15 and 16

The proposed wording of Article 15 and the deletion of Article 16 replicate the proposal contained in the Lithuanian Presidency compromise text.

CHAPTER V
TIMING AND QUANTIFICATION

Articles from 17 to 22

Articles 17 to 22 replicate the wording of the Lithuanian Presidency compromise text.

Article 23

Financial assets and liabilities held for trading (trading book)

General comments

Article 23 provides for specific rules as regards financial assets held for trading, which reflects a hidden reference to IAS/IFRS guidance. This Article aims at giving to financial trading a mark-to-market treatment (taxation of unrealised gains and losses) which would principally apply to financial institutions and MNEs performing trading activities.

The Italian proposal is aimed at addressing possible reclassification of financial assets or liabilities originally held for trading as assets that become entitled to PEX and vice-versa.

Paragraph 4

In case of disposal of financial assets or liabilities held for trading, paragraph 3 states that the proceeds shall not be exempted, thus derogating from Article 11(d). Paragraph 4 of the proposal clarifies that also profit distributed in respect of a holding held for trading shall be added to the tax base.

Paragraphs 5, 6 and 7

The Italian Presidency proposes to add specific rules on the possible change of destination of financial assets.

In particular, the change of destination (from held for trading to fixed asset and vice-versa) should be considered as an act of disposal. Furthermore, it is specified that the market value acquires relevance form the year following the change of destination.

Paragraph 6 creates a link with article 11(c) that grants the exemption on dividends if the shares have been held for at least 12 months. If a change of destination takes place, for calculating the holding period, the relevant holding period for PEX is interrupted or begins, depending on the original destination, since the date of the new classification.

The same perspective that takes into account the tax consequences of reclassifications has been adopted in cases of business reorganization, as stated in the new paragraph 7.

Article 25

Provisions

Article 25 replicates the wording of the Hellenic Presidency compromise text.

Article 26

Pensions

Article 26 replicates the wording of the Lithuanian Presidency compromise text.

Article 27

Bad debt deductions

Article 27 replicates the wording of the Hellenic Presidency compromise text.

Article 28

Hedging

Paragraph 1

The proposed paragraph 1 clarifies that the treatment of gains and losses, as regulated in Article 28, refers both to valuations and to acts of disposal on hedging instruments. This is with a view to ensuring full consistency with the rules regulating the disposal and the evaluation of these instruments.

Paragraph 2

In the Presidency's view, it is important to consider that the effectiveness of derivative instruments can change. Derivative instruments which, at the beginning, were expected to be highly effective can, after some time, no longer meet the condition under letter b) of paragraph 1 of Article 28 and become speculative derivatives (as financial assets or liabilities held for trading under Article 23).

The Italian Presidency therefore proposes to add specific rules for the cases when derivatives have been reclassified from hedging instruments to speculative derivatives, or when speculative derivatives already held are used as hedging instruments.

As in the case of financial assets or liabilities held for trading (Article 23), the proposed approach is to consider the change of destination as an act of disposal.

Furthermore, it is specified that the market value acquires relevance from the year following the change of destination.

Article 30

Insurance undertakings

General comments

The Italian Presidency replicates the proposal included in the Danish Presidency compromise text, according to which "all" assets held by life insurance undertakings and profit distributions received by such undertakings should be included in the tax base.

Article 31

Transfer of assets towards a third country or another Member State

General comments

The Presidency's proposal concerns a single taxpayer (resident company or permanent establishment of a non-resident taxpayer) or other taxpayers that do not fulfil the requirements for consolidation.

The suggested wording of Article 31 takes into account the principles laid down in the case law of the Court of Justice of the European Union.

Paragraph 1

The Presidency suggests splitting paragraph 1 into two sub-paragraphs: i) the first referring to all assets (individually depreciable or not subject to depreciation) except for those provided for by Article 39 ; ii) the second referring to fixed asset regulated by Article 39 of the CCCTB proposal, in order to clarify that the deemed disposal refers to fixed assets which are part of an asset pool and therefore should be depreciated together.

In the same paragraph 1, the Presidency suggests referring to the market value, with a view to clarifying how the transfer of the asset has to be evaluated for tax purposes.

Since delegates asked for clarification, it is suggested that the term "unrelieved expenses" is replaced by "undeducted expenses".

Paragraph 2

According to the proposed paragraph 2, the resident taxpayer, as well as the non-resident taxpayer with reference to its permanent establishment in a Member State, can exercise the option provided for by paragraph 4 (i.e. the payment by instalments or the suspension of the payment) when the following conditions are met:

- the third country is party of the EEA;
- there is an agreement on the exchange of information between the third country and the Member State of the resident taxpayer or that of the permanent establishment, comparable to Directive 2011/16/EU on administrative cooperation in the field of taxation.

Paragraph 3

The proposed paragraph 3 treats the transfer of a company's residence or of a EU permanent establishment of a non-resident taxpayer towards a third country or another Member State as a disposal.

The provision is based on the assumption that the taxpayer does not keep in the Member State of origin any fixed place through which the activity is carried on.

Regarding how the deemed disposal has to be evaluated for tax purposes, the new provision states that the market value criterion has to be applied. As regards the timing of the evaluation, the proposed provision clarifies that, similar to the case of the transfer of assets, the value which has to be included in the tax base of the taxpayer is the one in relation to the tax year of the transfer.

Finally, in the Presidency's view, it should be provided that the market value includes the goodwill, comprehensive of functions and risks transferred.

Paragraph 4

In line with the changes proposed to paragraphs 2 and 3, the proposal included in paragraph 4 treats the transfer of a taxpayer's residence or of a permanent establishment of a non-resident taxpayer towards another Member State or an EEA country.

The immediate recovery of tax on unrealized capital gains related to the transfer of the tax residence or of the permanent establishment of a non-resident taxpayer is not allowed by the former Member State and the taxpayer can opt for the suspension of the payment or for the payment by instalments, if the following conditions are met:

- the State of destination is a Member State or an EEA country;
- in case of an EEA country, there is an agreement providing for the mutual assistance for the recovery of tax claims between that country and the Member State of origin of the resident taxpayer or that of the permanent establishment, comparable to Directive 2010/24/EU of 16 March 2010.

Paragraph 5

The proposed paragraph 4 does not allow the suspension of the payment or the payment by instalments for transfer of stocks and works in progress, as well as all positive and negative components that are part of the income of the last tax year in the Member State of the taxpayer and are not related to the transferred assets.

Paragraph 6

The Italian Presidency suggests to provide for five-year instalments, if the taxpayer opts for this kind of payment.

Paragraph 7

The proposed paragraph 7 regulates the payment of interest and the issuance of guarantees. The inclusion of such a provision responds to the comments made by Member States at the WPTQ meeting of 16 October 2014.
In particular, interests are due in an amount equal to that as established by the State of residence of the taxpayer. Consistently, the issuance of guarantees is regulated by the domestic law of the Member State of residence of the taxpayer.

Paragraph 8

The proposed paragraph establishes that the request for suspension of payment or of payment by instalments must be filed to the Competent Authority of the Member State from where the assets, the residence or the permanent establishment of the taxpayer were transferred. The request must be filed by the last day allowed to pay the income tax referred to the last year of residence in that Member State.

Paragraph 9

Given the comments expressed by Member States at the WPTQ meeting of 16 October, the Italian Presidency has deleted the reference to delegated acts. As a consequence, new paragraph 9 deals with the cases of interruption of the suspension of the payment and of the payment by instalments.

Paragraph 10

The Italian Presidency suggests including, under paragraph 8, a provision under which, once the market value contributed to the calculation of the tax base of the taxpayer in the Member State of origin, such value has to be recognized also in the Member State of destination.

CHAPTER VI
DEPRECIATION OF FIXED ASSETS

Articles from 32 to 42

Articles 32 to 42 replicate the wording of the Lithuanian Presidency compromise text.

CHAPTER VII
LOSSES

Article 43

Article 43 replicates the wording of the Lithuanian Presidency compromise text.

CHAPTER XII
DEALINGS BETWEEN THE GROUP AND OTHER ENTITIES

Article 72
Exemption with progression

Article 72 replicates the wording of the Commission proposal.

Article 73
Switch-over clause

General comments

According to the Italian Presidency, the switch-over clause should not be intended as an anti-abuse provision and should rather be seen as a functional rule of the CCCTB proposal dealing with taxation of inbound income listed in Article 73.

Paragraph 1

In paragraph 1, the Italian Presidency suggests a new approach based on the effective tax rates to establish whether there is a low level of taxation in the third country.

The Italian proposal presented at the WPTQ meeting of 3 July was based on a comparison between the effective tax rate in the third country and an average statutory tax rate in the EU.

However, the EU Commission and several Member States claimed a lack of consistency between the two terms of the comparison (effective tax rate on the one side and statutory corporate tax rate on the other side). For this reason, the compromise proposal takes into account only the effective tax rates.

The effective tax rate in the third country is the ratio between the amount of corporate tax paid in the third country and the income highlighted in the profit & loss account (pre-tax income).

The result must be compared with the "CCCTB tax rate", which should be calculated as follows:

- determining the tax base that the third country entity would have declared under the CCCTB system;
- finding the tax that would have been due (one possible solution could be applying an average of statutory corporate tax rates applicable in Member States);
- calculating the ratio between the amount of corporate tax that would have been paid and the income highlighted in the profit & loss account.

Such a comparison between effective tax rate is consistent with the proposed Article 82 of the CCCTB directive.

As a consequence of the application of the "effective tax rate approach", the alternative requirement included in the Commission proposal (i.e. a special regime allowing for a substantially lower level of taxation than that of the general regime) has been deleted.

Paragraph 2

The Presidency would like to highlight that the proceeds from disposal of shares mainly reflect the value of the owned entity in terms of undistributed profit. For this reason, it is proposed that, in case of disposal of shares, it is necessary to determine the effective tax rate with reference to the entire holding period.

Paragraph 3

The Presidency is of the view that a jurisdiction which does not allow for adequate exchange of information should be regarded as a "low-tax jurisdiction" for the purpose of applying the exemption on dividends, capital gains and profits of a permanent establishment. Therefore, a new paragraph is proposed to reflect the requirement of the exchange of information.

Paragraph 4

In order to avoid the import of deductible expenses, it is proposed to add a paragraph 4 in which it is specified that paragraph 3 does not apply to losses incurred by a permanent establishment situated in a country that does not grant an effective exchange of information and to capital losses arising from the disposal of shares in an entity located in such a country.

Articles from 74 to 77

Articles 74 to 77 replicate the wording of the Commission proposal.

CHAPTER XIV
ANTI-ABUSE RULES

Article 80

General anti-abuse rule

The Italian Presidency is of the view that an anti-abuse rule which is based on a "sole purpose" test would be too restricted and, therefore, less effective. For this reason, the expression "*sole purpose*" has been replaced with "*main purpose or one of the main purposes".* This would enable tax administrations to use the anti-abuse provision in a wider range of situations.

Moreover, it has been specified that the definition of arrangement includes also single parts or steps that may be, on a stand-alone basis, not genuine.

Article 81

Article 81 replicates the wording of the Danish Presidency compromise text and reflects also the comments expressed by some Member States at the WPTQ meeting of 16 September.

Article 82

Controlled foreign companies

General comments

CFC rules, as designed by the Commission and proposed by the Italian Presidency, are such that they are triggered only in case of accrual to the participated entity of "tainted" income and if the foreign entity is located in a low-tax jurisdiction. Notwithstanding such a transactional approach as a necessary condition for applying the rule, all the income accrued to the foreign entity is to be taxed in the hands of the controlling company.

Paragraph 1

As in paragraph 1 of Article 73 (switch-over rule), the Italian Presidency suggests introducing in paragraph 1, letter (b), an approach based on the effective tax rates to establish whether there is a low level of taxation in the third country. This is to take into account the above described comments of several Member States on the necessity of comparing two consistent terms.

The method of calculating the effective tax rate in the third country and the comparable effective tax rate that would have been applied under the CCCTB system is the same method described in the comments to paragraph 1 of Article 73.

The Italian Presidency proposes to increase the threshold for tainted income up to 50 per cent and, at the same time, to delete the additional 50 per cent threshold for transactions with the taxpayer or its associated enterprises. However, it is suggested to provide for a special rule, which was already included in the Danish Presidency compromise text, for credit institutions and insurance undertakings. According to this provision, the CFC rule applies only in so far as more than 50 per cent of the entity's income included in the categories listed in paragraph 3 comes from transactions with the taxpayer or its associated enterprises.

The Commission's proposal provides for an exclusion of those companies whose principal class of shares is regularly traded on one or more recognized stock exchanges.

In the Danish Presidency compromise proposal this provision was deleted.

According to the Italian Presidency, the deletion of such an exclusion is worth being further evaluated by the Working Party.

Paragraph 3

As a consequence of the increase of the 50 per cent threshold provided for by the suggested paragraph 1, letter c), the additional 50 per cent threshold for transactions with the taxpayer or its associated enterprises provided for by paragraph 3 is deleted. This is to address cases where a foreign entity does not enter into transactions with associated entities but diversion of profits could still happen.

Furthermore, the Italian Presidency proposes to include "*income from services rendered to the taxpayer or its associated enterprise*" in the list of "tainted income".

Article 83a

Hybrid mismatch

Article 83a replicates the wording of the Danish Presidency compromise text, which is considered by the Presidency as a good starting point in order to find a solution to the mismatch issues.