



Council of the EU adopts new anti-hybrid rules (ATAD 2) – Outcome of ECOFIN meeting May 23

On May 29, 2017, the Council of the EU unanimously adopted, without discussion, the [Council Directive](#) amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (Anti-Tax Avoidance Directive – “ATAD 2”). This adoption follows an agreement reached by the Economic and Financial Affairs Council of the EU (“ECOFIN”) at a meeting on February 21, 2017 (see Luxembourg tax alert [2017-02](#)), and an [opinion](#) rendered by the European Parliament on April 27, 2017.

Furthermore, during the ECOFIN meeting of May 23, 2017:

- an agreement was reached on the proposal for a [Directive](#) on Double Taxation Dispute Resolution Mechanisms in the EU (‘the Directive’);
- a policy debate was conducted on the proposed Common Corporate Tax Base;
- an anticipated meeting to discuss the proposed introduction of a Financial Transaction Tax in a group of Member States ([not](#) including Luxembourg) was postponed.

Anti-Tax Avoidance Directive as regards hybrid mismatches with third countries (ATAD 2)

Background

Hybrid mismatches occur due to disparities between the tax treatment of certain income or entities in different countries. Building on its work on preventing hybrid mismatches between EU Member States (established in the form of the EU Anti-Tax Avoidance Directive (“ATAD 1”) adopted in July 2016 (see Luxembourg tax alert [2016-14](#)), on October 25, 2016 the Commission put forward a proposal to tackle arrangements that involve third countries as part of its corporate tax package.

The EU Member States discussed the ATAD 2 proposal during a meeting of the ECOFIN on December 6, 2016, but did not reach agreement (see Luxembourg tax alert [2016-27](#)). After a substantive examination of the carve-out options for hybrid regulatory capital in the banking sector and financial traders involving hybrid transfers, on February 21, 2017, the ECOFIN reached agreement on the [Presidency compromise text](#) on the Commission’s proposal on ATAD 2.

Hybrid mismatches with third countries

The final text of the ATAD 2 is consistent with the compromise text agreed by the Council in February 2017 and does not contain any substantive changes.

The main recommendations proposed by the European Parliament in its [opinion](#) of April 27, 2017, including extending the scope to hybrid mismatch arrangements exploited by two taxpayers that are not associated enterprises, were not adopted.

In line with the compromise text in February, the adopted ATAD 2 includes a carve-out option through to December 31, 2022, for hybrid regulatory capital in the banking sector, and a carve-out for financial traders involving hybrid transfers made in the ordinary course of business.

Next steps

Luxembourg and all other Member States have until December 31, 2019 to adopt and to publish the laws, regulations and administrative provisions necessary to implement ATAD 2, and must apply those provisions as of January 1, 2020, with the exception of rules on reverse hybrid mismatches, which must be transposed into domestic law by December 31, 2021.

Double Taxation Dispute Resolution Mechanisms

During the last ECOFIN on May 23, 2017, the EU finance ministers agreed on a new mechanism to resolve double taxation disputes.

Although mutual agreement procedures under double tax treaties between Member States and the EU Arbitration Convention already exist, they are lengthy, costly and do not always result in agreement. In addition, more effective dispute resolution procedures are considered necessary to address the potential side effects of measures taken to address BEPS. For this reason, the Commission considers that mechanisms available in the EU need to be improved with respect to scope, timeliness, certainty and access for taxpayers, while ensuring a uniform application within the EU.

The Directive introduces a mandatory and binding mechanism for resolving disputes that give rise to double taxation on business income and that arise from the application or interpretation of double tax treaties. The Directive contains clear deadlines for Member States to agree on solutions.

Taxpayers can initiate a mutual agreement procedure under which Member States must reach agreement within two years (this may be extended by up to one year, if justified). If the mutual agreement procedure fails, the arbitration procedure is automatically initiated, whereby an Advisory Commission composed of independent arbitrators and representatives of each Member State is set up. The Advisory Commission has six months (this may be extended by three months) to issue its opinion. The competent authorities of the Member States concerned then have six months to agree on how to eliminate double taxation in the disputed case. The final decision is binding on the Member States and, although it must be published, it does not establish a precedent. Taxpayers may refer to their national court, if the Advisory Commission is not set up within a certain timeframe.

Member States can agree to set up an Alternative Dispute Resolution Commission instead of the Advisory Commission. The Alternative Dispute Resolution Commission has more flexibility in terms of dispute resolution processes and the techniques used.

The ECOFIN agreed on the following three issues:

- a **broad scope**, with the possibility to exclude, on a case-by-case basis, disputes that do not involve double taxation;

- **independent arbitrators** must not be employees of tax advisory organizations or have given tax advice on a professional basis. In principle, the chair of the Advisory Commission will be a judge;
- the possibility of setting up a **standing committee**, i.e. a permanent structure to deal with dispute resolution cases, if Member States agree.

The legislative procedure for the Directive is consultation, meaning that the Council will adopt the text once the European Parliament has given its (non-binding) opinion. A vote in the European Parliament's ECON committee is scheduled for June 8, 2017, and a plenary session is scheduled for July 4, 2017.

Once adopted, Member States will have until June 30, 2019 to transpose the Directive, which will apply to complaints submitted after that date on issues relating to tax years starting from January 1, 2018. However, Member States may apply the Directive to complaints related to earlier tax years.

Common Corporate Tax Base (CCTB)

During the ECOFIN meeting of 23 May 2017, a policy debate took place on the CCTB proposal. Please refer to the Luxembourg tax alert [2016-27](#) for more details on the proposed CCTB.

Representatives of the Member States expressed concerns on the impact of the CCTB on tax revenues and the potential harm to the EU's competitiveness in global markets. A few Member States noted the need for flexibility in implementing the CCTB, in particular the super-deduction for research and development expenses and the new allowance for growth and investment due to the absence of corresponding domestic rules. The Commission, along with several other Member States, expressed the concern that too much flexibility can be detrimental to the objective of harmonization. In addition, some Member States (including [Luxembourg](#)) mentioned concerns raised by their national parliaments with regard to the compliance of the CCTB proposal with the subsidiarity and proportionality principles.

Technical work will continue in the working groups, including a more detailed assessment of the impact on national budgets. The Finance Minister of Estonia expressed the intention to continue working on this proposal during Estonia's Presidency of the Council, starting in June.

KPMG Luxembourg comment

The adoption of **ATAD 2** represents the EU's commitment to combat tax avoidance through exploitation of hybrid mismatches between Member States and third countries. The practical implications for existing and future arrangements will need to be carefully examined after the Directive is transposed into national law.

The proposed **double taxation dispute resolution mechanism** should enhance tax certainty and as such contribute to the European Commission's efforts to improve the business environment in the EU. The proposed Directive must be seen in the context of the recent focus on tax certainty by both the OECD and the EU.

The debate on **CCTB** makes clear that some Member States still have strong reservations on this matter. As the initiative is subject to unanimous approval by Member States, the current proposals may have to undergo significant amendments in order to achieve final agreement, in particular by granting more flexibility to Member States.

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