Euro Tax Flash from KPMG's EU Tax Centre

ECOFIN discusses range of issues including energy taxation and the status of the EU blacklist

ECOFIN – Energy Taxation – EU Blacklist – CCTB – Harmful Tax Regimes – Code of Conduct Group Report – Financial Transaction Tax – Public CBCR – Digital Taxation

In a meeting on December 5, 2019, the Economic and Financial Affairs Council of the EU (ECOFIN) exchanged views on a range of issues including a revised framework for energy taxation and the status of the EU blacklist of non-cooperative jurisdictions. The EU Finance ministers also reviewed a report by the Code of Conduct Group and took stock of work completed under the Finnish Presidency of the EU Council in areas including the taxation of the digital economy, public country-by-country reporting and the status of the Common Corporate Tax Base (CCTB) file.

Energy Taxation

The taxation of energy and the wider impact of climate change has been a key area of focus internationally in recent times. At the ECOFIN meeting on December 5, 2019, the EU Council adopted the draft conclusions on the EU energy taxation framework.

The conclusions invite the European Commission to take measures to ensure a transition to a climate-neutral EU in line with commitments given in the Paris Climate Agreement. The conclusions state that the current version of the Energy Taxation Directive is not fit for purpose and should therefore be reviewed by the European Commission and updated accordingly. In doing so, the conclusions call on the European Commission to give particular consideration to the scope of the Directive, the use of minimum tax rates and specific tax reductions and exemptions.

In addition, in order to ensure that amendments to the Directive are practicable and provide greater certainty and clarity in implementation, the energy taxation framework conclusions call on the EU Commission to consider:

- the treatment of biofuels and other alternative fuels;
- the applicability of control and movement provisions to certain products, such as the treatment of lubricants and designer fuels;
- new energy products and technologies (including relevant sectors such as aviation, taking into account their specificities, existing exemptions and international dimensions);
- the impact on government revenues; and
- State aid processes and rules.

The conclusions also highlight the importance of a full assessment of any proposal being performed in terms of its economic, social and environmental costs and benefits and the related implications for competitiveness, connectivity, employment and sustainable economic growth, particularly for sectors most exposed to international competition. These points were emphasized by a number of Member States during discussions at the ECOFIN meeting. The European Commission is requested to bring-forward proposals for revisions to the Energy Taxation Directive in due course.

EU Blacklist Update

During their meeting, the EU Finance ministers took stock of the progress made in relation to the EU blacklist and “grey list” of non-cooperative jurisdictions for tax purposes during the Finnish Presidency of the EU Council. While no jurisdictions were added or removed from the EU blacklist or “grey list”, the progress of a number of jurisdictions in addressing their commitments was recognized.

Defensive measures for non-cooperative jurisdictions

As part of the work on the EU blacklist of non-cooperative jurisdictions, the EU Council has stressed the need for Member States to agree to take coordinated defensive measures against blacklisted jurisdictions. Progress was made in this area under the Finnish Presidency and it was agreed in the framework of the Code of Conduct Group that Member States should apply at least one of the following defensive legislative measures against non-cooperative jurisdictions:

i. **Non-deductibility of costs**: Member States that opt for this measure should deny a deduction of costs and payments that otherwise would be deductible for the taxpayer when these costs and payments are directed to entities or persons in listed jurisdictions. The measure should include for example interest, royalties and other concessions on intellectual property (IP) assets and service fees.

ii. **Controlled Foreign Company (CFC) rules**: Member States that opt for this measure should include, in the tax base of the taxpayer, the income of an entity resident or a permanent establishment situated in a listed jurisdiction. Member States could apply this measure in accordance with to the rules laid down in articles 7 and 8 of the Anti-Tax Avoidance Directive (EU) 2016/1164.

iii. **Withholding tax measures:** Member States that opt for this measure should apply withholding tax at a higher rate for example on payments such as interest, royalties, service fee or remuneration, when these payments are treated as received in listed jurisdictions. Alternatively or in combination with this measure, Member States could consider applying specific targeted withholding tax to such payments.

iv. **Limitation of participation exemption** on profit distribution: Member States that have rules that permit the exclusion or deduction of dividends or other profits received from foreign subsidiaries could deny or limit these participation exemptions if the dividends or other profits are treated as received from a listed jurisdiction.

v. **Administrative measures:** Member States should apply at least one of the following administrative measures, (a) reinforced monitoring of certain transactions; (b) increased audit risks for taxpayers; (c) increased audit risks for taxpayers.

The Guidance, which is not binding on Member States, also suggests that Member States could apply a reversal of the burden of proof and special documentation requirements to reinforce the effect of any of the defensive measures.

Code of Conduct Group Report

On November 25, 2019, the Code of Conduct Group ("the Group") released a report to ECOFIN on the work performed by the Group during the second half of 2019. At the ECOFIN meeting on December 5, 2019, EU Finance ministers endorsed the report and adopted a number of the corresponding recommendations. For more detail on the Code of Conduct Group, please refer to ETF 387.

Activity under the Finnish Presidency

On November 25, 2019, the Code of Conduct Group (Business Taxation) presented its report to the ECOFIN meeting on the Finnish EU Presidency work programme which was published on July 10, 2019. The report addresses the review process applied to the patent box and notional interest deduction regimes of Member States and recalls the work performed by the Group on the EU blacklist.

With respect to standstill review process, the Group concluded that the patent box regime of Malta is not harmful. While the Group also concluded that the Polish notional interest deduction regime is not harmful, the Polish Investment Zone regime was found to be a harmful regime. The Group also reviewed the status of amendments to the Cypriot notional interest deduction regime. The standstill review of Romania's profit tax exemption for companies with innovation and R&D activities was kept on hold until the relevant national legislation is adopted. In relation to the rollback review process, the Group reviewed the status of the rollback of Lithuania's holding company regime and noted that the amendments have been approved by the Lithuanian Government and have been submitted to the Lithuanian Parliament for approval before the end of 2019.

The Group endorsed guidance prepared in respect of notional interest deduction regimes. The guidance is intended to assist Member States that wish to implement a notional interest deduction regime that is similar to those regimes that have already been assessed and deemed not to be harmful. The Group also noted that it had used this guidance as the basis for assessing similar regimes with the equivalent regime in Switzerland examined by a Code of Conduct sub-group on November 4, 2019.

The report also states that the Code of Conduct Group had prepared a new set of consolidated guidance on its approach to assessing foreign source income exemption regimes which is intended to provide clarity for jurisdictions that have committed to amending existing regimes that have been classified as being harmful. This guidance had been used as the basis for a preliminary screening of a number of regimes, the results of which were discussed at a meeting of the Group on October 24, 2019. The ECOFIN report recommended that the Group starts a more formal assessment of the regimes identified, with an initial focus being placed on nine jurisdictions that are either classified (i) as developed countries or (ii) as developing countries that contain a financial center.

State of Play of Other EU Initiatives

At the ECOFIN meeting, EU Finance ministers also reviewed the progress made on other EU taxation initiatives. In particular, ministers noted that progress has been made in the areas of digital taxation, the taxation of financial transactions and the common corporate tax base (CCTB) proposal.

CCTB

The common corporate tax base directive ("CCTB Directive") proposal was re-launched in 2016 and the ECOFIN report charts the discussions that have taken place during the Maltese, Estonian, Bulgarian and Austrian Presidencies of the European Council. Technical work on this file has continued under the Finnish Presidency and has focused on areas that are not directly related to the scope of CCTB (which remains a contentious issue between Member States). In particular, the Finnish Presidency focused on the treatment of leasing activities, transparent entities and the impact of transfer pricing. Due to differences in the preferred approaches of Member States, it was agreed that additional technical work was required on each of these issues.

Financial Transaction Tax

Taxation of the financial sector has been under discussion at the European level since 2011, when the European Commission first proposed implementing a financial transactions tax (FTT) at EU level. After initial discussions, it became apparent that unanimous support amongst EU Member States did not exist. For further information on the development of an FTT at EU level, please refer to ETF 406.

At the ECOFIN meeting, it was noted that negotiations in relation to the FTT proposal are still proving to be complicated. Where an agreement be reached amongst the Member States that are authorized to move forward under enhanced cooperation procedures, it was highlighted that this would only represent a first step in the legislative process. If a draft Directive text is tabled by the relevant Member States, an inclusive and substantial debate between all Member States would need to take place at the EU Council.

Public Country-by-Country Reporting

The ECOFIN meeting also considered information provided by the Swedish delegation on a public country-by-country reporting (public CBCR) directive proposal.

In April 2016, the European Commission presented a proposal for a directive on the disclosure of income tax information (public CBCR). Under the proposal, certain multinational enterprises would be obliged to disclose details of the income tax paid as well as other specified tax-related information publicly on a country-by-country basis.

Public CBCR proposals were recently resisted by a number of Member States at an EU Competitiveness Council meeting. This was echoed by some delegations at the ECOFIN meeting with certain delegations citing concerns over the legal basis of public CBCR, its interaction with the automatic exchange of information and other work being undertaken at OECD level. The Swedish delegation also noted that the proposal on public CBCR is an example of a proposal on direct tax matters that should be subject to unanimity in the European Council. Despite the political deadlock on the file, the European Commission confirmed during a press conference that it has no intention of withdrawing the proposal.

EU Tax Centre Comment

As shown above, a wide range of issues were discussed by EU Finance ministers during the ECOFIN meeting on December 5, 2019. As the Finnish Presidency of the EU Council is drawing to a close, the meeting presented an opportunity for Member States to draw breath and take stock of the work performed in 2019 and the state of play of a number of areas at year-end. Member States also used the ECOFIN meeting to re-emphasize their commitment to a number of topical issues including energy taxation, climate action and enhanced measures to tackle tax evasion. It is expected that developments in these areas will continue at pace throughout 2020.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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