

The Weekly Report from Brussels, provided by the European Affairs team at the City of London, provides an update on key developments relating to financial services in the EU.



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Welcome to the Weekly Report, prepared by the City of London European Affairs team.

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Proposal to close Hybrid Mismatches unanimously approved by ECON Committee

On 27 March, the Economic and Monetary Affairs (ECON) Committee **backed** a report calling for changes to the Anti-Tax Avoidance Directive (ATAD) to address hybrid mismatches. The report was backed unanimously by the Committee.

Background:

A hybrid mismatch is a situation where a company earns revenues in two or more jurisdictions and each country applies different rules for taxing certain income or entities. These mismatches allow companies with cross-border activities to exploit differences in national tax systems and avoid taxes.

In July 2016, the Council **approved** the Anti-Tax-Avoidance Directive (ATAD) aiming to tackle aggressive tax planning and boost tax transparency, the proposal for which derived from OECD recommendations on **Base Erosion and Profit Shifting (BEPS)**. When adopting ATAD, the Council requested that the Commission put forward a proposal on hybrid mismatches involving third countries.

Thereafter, in October 2016, the Commission proposed a **directive** (as part of the **Corporate Tax Reform Package**) which set out new rules on hybrid mismatches. It sought to neutralise mismatches by obliging Member States to deny the deduction of payments by taxpayers or by requiring taxpayers to include a payment or a profit in their taxable income.

Latest Developments:

The proposal was submitted to Parliament for consultation and Olle Ludvigsson MEP (S&D, Sweden) was appointed rapporteur. On 2 February, Mr Ludvigsson published a **report** detailing the Committee's recommendations. The report offers amendments to the directive which would cover additional types of hybrid mismatches, specifically permanent establishment mismatches and reverse hybrid mismatches:

- **Permanent establishment mismatches** occur when an entity has permanent establishment in a Member State and residency in another jurisdiction, which both apply different rules for allocating income and expenditure between the different parts of the same entity, which allows the entity to claim a tax deduction in both jurisdictions. In such cases, the report proposes that the jurisdiction in which the entity is resident should include the income that would otherwise be attributed to the permanent establishment.
- **Reverse hybrid mismatches** occur when a hybrid entity which is incorporated in a Member State that deems the entity to be transparent, but is owned by an associated entity that is deemed non-transparent by the jurisdiction in which it is resident. In such cases, the report proposes that the Member State regards the hybrid entity as a resident of the Member State for tax purposes.

The report also removes provisions which would only target mismatches that arise from a 'structured arrangement' which was designed to produce a mismatch, recommending that the directive cover all mismatches, whether intentionally designed or not.

Members of the Committee agreed that the Commission's proposed directive effectively reduces the possibilities for corporate tax avoidance, but also called for more to be done to target other types of mismatches which were not included in the directive, as this would further minimise the opportunities for profit shifting. Mr Ludvigsson said "it is vital that the rules agreed by EU ministers tackle a more far-reaching range of complex structures in order to narrow the scope of tax avoidance. It will ensure that multinationals having cross-border activities in the EU or outside the EU pay due taxes in Europe. Taxes must be paid where profits are generated".

The Report was approved by the Committee by 41 votes to 0, with 2 abstentions.

Next Steps:

The European Parliament will only play a consultative role in this piece of legislation but the Council can only vote on the directive once the Parliament has offered its opinion. Once MEPs have voted in plenary, scheduled for 27 April, the Council will **consider** the directive, requiring unanimity for its approval.

Parliament and Council set out positions on negotiations with the UK

On 29 March the UK government invoked Article 50 with the presentation of Prime Minister May's **letter** to Donald Tusk, President of the European Council, formally notifying him of the UK's intent to leave the EU. In response, the European Parliament and the Council of the European Union set out their positions on the forthcoming negotiations following the UK's formal notification.

European Parliament:

On the same day that the Sir Tim Barrow, Permanent Representative of the UK to the EU, presented President Tusk with the British Prime Minister's letter triggering Article 50, the European Parliament published its **draft resolution** which setting out conditions for approving the UK withdrawal agreement. Whilst the European Parliament will play only a consultative role in the negotiations on the UK's exit from the EU, any agreement reached by the UK and the European Council must be approved by Parliament.

The resolution was drafted by the leaders of four Parliamentary groups (but notably not the leader of the ECR group, which includes the UK Conservative Party) and the Chair of the Constitutional Affairs (AFCO) Committee, and will be debated and voted on by MEPs (including UK MEPs) in Strasbourg on 5 April.

Conditions for Parliament's approval of any agreement include:

- Any future agreement between the UK and the EU should not contain participation in the Single Market on a sector-by-sector basis, singling out financial services.
- Any future relationship which includes membership of the Single Market must include, continued oversight by the Court of Justice of the European Union, acceptance of the four freedoms and budget commitments.
- A transitional deal is possible but should not exceed three years and should be "limited in scope as there can never be a substitute for union membership".
- No cut-off date after which EU nationals coming to the UK lose the automatic right to residency in the UK may be implemented before the UK's exit.
- The UK cannot begin negotiations on trade deals with third countries while it is still a Member State. Any attempt to negotiate a bilateral agreement with a Member State separately would go against the Treaties.

European Council:

On 31 March, a **document** produced by the Council setting out the draft framework for the negotiations with the UK was leaked to the press. The European Council had intended to publish the document at the same time it was sent to Member States, but two governments objected to the guidelines immediately being made public.

Core principles:

The document states the importance of Member States maintaining a united position during the negotiations and declares that the EU will be constructive and work towards a deal that is in the interests of both sides, although it recognises that the negotiations may fail. It also sets out the core principles that the EU intends to follow during the negotiations, namely that, once it is a third-country, the UK cannot receive the benefits of the Single Market without taking on the obligations, and rules out granting participation in the Single Market on a sector-by-sector approach. Additionally, it rules out undercutting the negotiations by allowing separate negotiations between individual Member States and the UK.

Framework for negotiations:

The document calls for a phased approach to negotiations, with the first phase focussing on the terms of the UK's exit; the second on the future arrangement between the EU and the UK; and, if possible, a final phase providing for a transitional period. It states that the negotiations on the terms of the UK's exit must be concluded before any agreement on a future or transitional relationship is concluded. It allows for the negotiations on a future relationship to begin before the exit negotiations are concluded, but the future relationship agreement can only be concluded after the UK has become a third-country. A transitional agreement will only be sought if it is in the interests of the EU and providing that it is clearly defined, limited in time, and subject to effective enforcement mechanisms.

Issues of Priority

The document calls for priority in the negotiations to be given to issues necessary for an orderly withdrawal, namely:

- Agreeing reciprocal guarantees for EU citizens residing in the UK and UK citizens residing in the EU, and their families. Such guarantees should be enforceable and non-discriminatory.
- Addressing the legal uncertainties for businesses which have entered into contracts or take part take in EU-funded programmes based on the assumption of continued British EU membership.
- A single financial settlement between the UK and the EU which covers all legal and budgetary commitments as well as liabilities, including contingent liabilities.
- Finding solutions to address the unique circumstances posed by Northern Ireland and the Good Friday Agreement.
- Ensuring that the UK honour its share of international commitments contracted in the context of its EU membership.
- To ensure legal certainty, contracts entered into prior to withdrawal are grandfathered so that the Court of Justice of the European Union remains competent to adjudicate such cases.

- The withdrawal agreement should include appropriate dispute resolution mechanisms regarding the application of the withdrawal agreement.

Framework for a future deal:

The document conveys an openness to an ambitious and wide-ranging free trade agreement, but that such an agreement mustn't undermine the Single Market. Any free trade agreement must also include safeguards to prevent either side holding an unfair competitive advantage and must include appropriate enforcement and dispute resolution mechanisms. Additionally, the EU is open to establishing partnerships in other areas in a future relationship, in particular the fight against terrorism and international crime as well as security and defence.

EU reactions to UK Governments Article 50 letter

Here are the key reactions and commentary from EU policy-makers and Member States following the formal triggering of Article 50 by the UK Government.

European Council:

After Permanent Representative Tim Barrow presented the letter to President of the European Council Donald Tusk, the European Council released a **statement**.

It stated that the EU-27 regretted that the UK will now leave the EU, but was willing to begin negotiations constructively. It said "In these negotiations the Union will act as one and preserve its interests. Our first priority will be to minimise the uncertainty caused by the decision of the United Kingdom for our citizens, businesses and Member States" and "In the future, we hope to have the United Kingdom as a close partner".

A draft of the statement leaked to the press said the following, not included in the official statement: "Should the negotiations fail, we will make sure that the European Union is ready for such an outcome even though we do not desire it".

President of the Council Donald Tusk gave a **statement**, where he said that whilst no one was happy that the UK will leave the EU, "paradoxically Brexit has made us more determined and more united than before". He said that the mandate of the EU was to "protect the interests of the EU-27. There is nothing to win in this process (for either side). The goal is clear: to minimise the costs for the EU citizens, businesses and Member States".

European Commission:

The Commission's Taskforce on Article 50 negotiations with the United Kingdom published a **timetable** for how negotiations will proceed.

Michel Barnier, Chief Negotiator for the Commission, announced that his team was ready to reach an agreement on the orderly withdrawal of the United Kingdom and called on the EU-27 Member States to remain united during the negotiations.

President of the European Commission Jean-Claude Juncker described the triggering of Article 50 as a sad day for the EU and as a decision which the UK would regret in the future. He also said "but I'm feeling fine tonight, because we have this kind of dialogue and because we are talking about the European future and, in fact, although we have our weaknesses and our failures, we should consider that Europe is the best place on earth to live".

European Parliament:

President of the European Parliament Antonio Tajani MEP (EPP, Italy) stated that the UK invoking Article 50 marks a new chapter in the EU's history, but it's ready and will move on. He stated that residency rights of EU citizens in the UK were a priority, as well as ensuring the UK pays all its commitments and continues to observe treaty obligations until it leaves. With this in mind, he warned that "unilateral decisions affecting the rights of EU citizens before the UK withdraws will be contrary to the treaties, therefore illegal".

European Parliament negotiator Guy Verhofstadt MEP (ALDE, Belgium), and leader of the **ALDE group**, was strongly critical of the statement in Theresa May's Article 50 letter which seemed to threaten that the UK would weaken security commitments to the EU if the UK is denied a trade deal. He responded that security cooperation cannot be traded off against economic considerations, and said "what we shall never accept is that there is a trade-off ... I think the security of our citizens is too important start a trade-off between one and the other".

The **EPP group** released a **statement**, stating that the invocation of Article 50 begins three separate negotiations (exit, transitional arrangements and future relationship), and that three priorities for the EPP will be settling residency rights for EU citizens in the UK (and vice-versa), settling the payments that the UK needs to settle and ensuring that peace in Northern Ireland is not jeopardised. Group leader **Manfred Weber MEP (EPP, Germany)** also said that the EU has done everything to keep the UK in the EU, but, from now on, only the interests of EU-27 citizens should be prioritised. He also said "we'll have to have a very tough position on Brexit. People will see it's a dangerous exercise to leave the Union".

The **S&D group** released a **statement** from group leader **Gianni Pittella MEP (S&D, Italy)**, which said "contrary to the false promises of the Brexiters' propaganda, leaving EU will involve difficult decisions and there will be unexpected and often harmful consequences". He said that the S&D's priorities will be to safeguard the rights of EU citizens living in UK and the UK citizens living in the EU, maintaining the four freedoms of the single market, preventing a hard border between Ireland and Northern Ireland, and ensuring that the UK honours all outstanding financial commitments.

The **ECR group** released a **statement** from group leader **Syed Kemall MEP (ECR, UK)**, which said that the negotiations must not be about winners and losers as "a bad deal for one side will also be bad for the other. We should aim for an arrangement that safeguards trade and allows continued co-operation in key areas of mutual interest for our security and economies". He also said that the ECR group believes that Brexit will be an opportunity for EU reform.

Markus Ferber MEP (EPP, Germany), Vice-Chair of the ECON Committee, said that “the UK was a Member State with special privileges, but in cannot expect to be a non-Member State with special privileges”.

Brian Hayes MEP (EPP, Ireland), member of the ECON Committee, said that the UK triggering Article 50 is a “monumentally stupid act of self-destruction”, that Ireland will remain in the EU and the EU will remain strong. He released a **statement** calling for early assurances that the final agreement will be voted on by unanimity.

Udo Bullmann MEP (S&D, Germany), member of the ECON Committee, welcomed the news that the Commission had blocked the proposed merger between Deutsche Börse and London Stock Exchange, arguing that it would be the wrong decision given the uncertainty of what the regulatory framework will be after the UK’s exit.

Bernd Lucke MEP (ECR, Germany), member of ECON and PANA Committees welcomed the UK beginning the process of leaving the EU, warning that if the EU is not reformed, more Member States are likely to follow suit.

Sylvie Goulard MEP (ALDE, France), member of the ECON Committee, stated that the UK take a less emotional position and reflect on its long-term interests, noting that should the UK decide not to respect all of its commitments, such as budget commitments, it would not only make the exit negotiations more difficult and damage future relations with EU countries, but it would make itself less reliable to other countries negotiating trade agreements. She also stressed that the UK shouldn’t expect to change the EU through its departure.

Danuta Huebner MEP (EPP, Poland), Chair of the Constitutional Affairs Committee, reiterated the challenge of negotiating both a withdrawal agreement and a future relationship that will be acceptable to both sides.

Reactions from Member States:

Germany: Chancellor Angela Merkel said the EU is losing a strong and important Member State and added that the U.K. should remain an important partner of the EU. She stressed that there should be no talks on the future arrangement between the UK and the EU before both sides have agreed on the terms of the UK’s exit.

Hans-Peter Friedrich, the chair of the Brexit working group in the Bundestag, said that “we expect transparent negotiations, during which not just the European Parliament but also the national parliaments can (contribute)”. Foreign Minister Sigmar Gabriel said the process would not be easy for either side due to ‘lingering bad feelings’, but this could not be allowed to affect the talks.

Estonia: Prime Minister Jüri Ratas issued a **statement** saying the EU cannot allow itself to be paralyzed by Brexit and must decisively move on together. Estonia will hold the Presidency of the European Council during the second half of this year, and he said “we will do everything we can so that Brexit shall go according to the rules, and we hope that we will have the opportunity to discuss future relations very soon”.

Ireland: The Irish Government released a **statement** saying that it is clear that the UK's departure from the EU will have significant economic, political and social implications for Ireland and that while the exit negotiations should also involve discussion of the future relationship, many of the issues are unlikely to be resolved quickly. It also said that the Irish Government would publish a paper detailing its priorities and approach to the negotiations ahead of the next European Council meeting on 29 April.

Netherlands: Prime Minister Mark Rutte said that the Netherlands and the UK share a long history as neighbours, friends and trade partners. He said that it's hugely important that the EU and UK find an effective, working relationship, and that the Government will put Dutch citizens and companies first in the negotiations.

Denmark: Prime Minister Lars Løkke Rasmussen said the negotiations will not be easy, but hopes the UK and the EU will engage constructively, as it is in both sides interest. However, he also said that the UK's decision to leave the EU and the single market will have consequences, as no country can have the benefits of single market without any of the costs.

Austria: Chancellor Christian Kern says clarifying the status of EU citizens living in Britain was a priority for his government, as well as achieving clarity and legal certainty for Austrian companies operating in the UK. Foreign Minister Sebastian Kurz says that Brexit is a "turning point" for the EU, arguing that it needs to change so that it becomes 'bigger on the big issues' and it should not interfere in areas where member states can make their own decisions.

Sweden: Prime Minister Stefan Löfven issued a **statement** saying that the UK has been a close and valuable partner in the EU and that Sweden regrets the UK's decision to leave, but welcomes the fact that the negotiations can now begin. Sweden's key priorities in the negotiation are an agreement where the UK pays for commitments made, residency rights for EU citizens in the UK, and vice versa, and close trade relationships between the UK and the EU, with effective cooperation to continue in other areas, including security

Italy: Foreign Minister Angelino Alfano explained Italy's approach to the negotiations. He said the discussions will be difficult, but that the EU should not take a punitive approach. Whilst the UK's exit cannot result in it having a better deal than if it retained EU membership, it is important for the UK and the EU to have a close trading relationship.

In other news

- The European Commission has **blocked** the proposed merger between Deutsche Börse and London Stock Exchange arguing it would have created a de facto monopoly in the markets for clearing fixed income instruments
- The BUDG Committee **voted** to provide greater flexibility to redirect funds to tackle urgent challenges (such as the migration crisis and strengthening security) within the remainder of the Multi-annual Financial Framework (MFF) 2014-2020

- The ECON Committee **voted** to extend European statistical programme (ESP) 2013-2017 for the period 2018-2020 and to provide financial support to the European statistical system (ESS)
 - The ECB **facilitated** a project by Transparency International to enhance its transparency, accountability and integrity mechanisms
 - Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the ECB, delivered a **speech** on FinTech and innovative banking at an ECB Fintech Workshop
 - The Basel Committee on Banking Supervision today released a **consultative document** on proposed revisions to the global systemically important banks assessment framework
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Upcoming EU Institutions events and consultations

31 March: Deadline for ESMA **consultation** on ESMA's Guidelines on transfer of data between TRs

28 April: Deadline for EIOPA **consultation paper** on the Proposal for Guidelines under the Insurance Distribution Directive on Complex Insurance Based Investment Products

5 May: Deadline for EBA **consultation** on RTS on CCP to strengthen fight against financial crime

16 May: Deadline for responses to EBA **consultation** on Guidelines on procedures for complaints of alleged infringements of the PSD2

City of London Research

The City of London produces regular research on EU Financial Services which can be accessed **[here](#)**.

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