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REPORT

From:	Code of Conduct Group (Business Taxation)
To:	Permanent Representatives Committee/Council
Subject:	Code of Conduct Group (Business Taxation) • Report to the Council = Endorsement

I. Background

1. On 1 December 1997, the Council and the Representatives of the Governments of the Member States, meeting within the Council, adopted a Resolution on a Code of Conduct for business taxation. This Resolution provides for the establishment of a Group within the framework of the Council to assess tax measures that may fall within the Code.

2. In its conclusions of 9 March 1998 (doc. 6619/98), the Council confirmed the establishment of the Code of Conduct Group. The Group reports regularly on its work and these reports are forwarded to the Council.

3. The Code of Conduct provides that the Group reports "*will be forwarded to the Council for deliberation and, if the Council so decides, published*". Furthermore, the March 1998 Council conclusions indicate that these reports will reflect either the unanimous opinion of its members or the various opinions expressed in the course of the discussion. The procedural elements that were part of the 2008 Work Package (doc. 16410/08) further detailed that the report to ECOFIN can indicate the number of Member States concerned without qualifying their views and be edited in such way that ECOFIN can have a "*clear and focussed discussion on the key elements at stake*".

4. In accordance with the Procedural Aspects of the Group (doc. 16410/08), the Group should maintain to aim at a (broad) consensus to reflect the positions of the Member States in the Group in its reports to ECOFIN, to avoid losing the effectiveness of the Group, while respecting the principle of unanimity as laid down in the Council conclusions of 9 March 1998 concerning the establishment of the Code Group. In the case broad consensus cannot be reached, the Group's reports can express the various views mentioned.

5. In its Conclusions adopted on 8 March 2016 (doc. 6900/16), the Council "*calls for having more substantial 6-monthly Group reports to ECOFIN, reflecting the main elements and views, which were discussed under specific items and reporting also on the monitoring concerning (non-) compliance with agreed guidance*" (paragraph 16).

6. This report from the Code Group encompasses the work of the Group in the second half of 2017 under the Estonian Presidency.

II. General aspects

7. The Code of Conduct Group met four times under the Estonian Presidency, on 20 July, 18 September, 17 October and 22 November 2017. The Group continued the work on the basis of the new Work Package approved by the Council (ECOFIN) on 8 December 2015 (doc. 14302/15).

1. Work programme

8. At its meeting on 20 July, in line with the work package, the Group decided to focus work during the Estonian Presidency on the following items (WK 8254/2017 INIT):

- Monitoring of standstill and the implementation of rollback.
- Monitoring developments in the administrative practices of Member States.
- Continuation of the work on the establishment of the EU list of non-cooperative jurisdictions.
- Links with third countries: with regard to Liechtenstein, continuation of the dialogue on harmful regimes and, concerning Switzerland, monitoring of the outcome of the dialogue.
- Monitoring Member States' compliance with agreed guidance.
- Procedural issues: continuation of the work regarding the clarifications of the third and fourth criteria, and launch of work on guidelines setting working methods for an effective monitoring of Member States' compliance with agreed guidance.

2. Appointment of Vice-Chairs

9. Elo Madiste (Estonia) and Lyudmila Petkova (Bulgaria) were confirmed as respectively the first and the second Vice-Chairs for the period up to the end of the Estonian Presidency.

III. Standstill and rollback

A. Standstill

10. At the meeting on 25 January 2017, the Commission services informed the Group that five Member States had notified new measures on standstill for the year 2016: Croatia, Latvia, Lithuania, Luxembourg and Poland. Those notified by Latvia, Luxembourg and Poland have been settled under the Maltese Presidency.

1. Netherlands: Aruba

11. In 2016, the Netherlands notified the Group of some amendments made by Aruba (one of the fiscal autonomous countries within the Kingdom of the Netherlands) to its Imputation Payment Company (IPC) regime. At the meeting on 25 January, the Commission services indicated that there were still some questions open. At the meeting on 5 April, the Commission services presented an agreed description and the Group decided to move to the assessment stage.

12. At the meeting on 8 June 2017, the Netherlands informed the Group on behalf of Aruba that the IP elements in the regime will be effectively repealed within three months. The Group took note and asked the Commission services to monitor this process. The IP elements in the regime were effectively repealed as from 28 October 2017.

2. Croatia

13. In 2016, Croatia notified to have enacted a new Act on Investment Promotion which replaced the previous Act on Investment Promotion and Improving the investment Climate.

14. At the meeting on 25 January 2017, the Commission services indicated that the description of the regime was agreed with Croatia. The Group decided to go to the next stage, i.e. the assessment of the measure.

15. At the meeting on 20 July 2017, Croatia informed that the legislation would be amended by end of the third quarter 2017.

16. At the meeting on 17 October, Croatia informed the Group that a state aid investigation of the regime was ongoing by the Commission. Against this background, it was agreed to suspend the standstill review in the Group.

3. Lithuania

17. The existing corporate tax regime for special tax zones has been extended by adding additional activities focused on the provision of specified services such as accounting, bookkeeping and consulting (except for audit, accounts expertise or verification), office administration and servicing, human resource activities, architecture, engineering and related technical consulting (except for control of construction works and location shooting).

18. At the meeting on 8 June 2017, the Group agreed that, based on the description, the regime as notified does not need to be assessed against the Criteria of the Code. Lithuania agreed to provide additional information on the possible IP component of the regime in order for the Commission to examine this aspect.

19. At the meeting on 20 July the Commission, after receiving further additional information from Lithuania, was of the opinion that the regime did not create any BEPS issue. This conclusion was endorsed by the Group which decided that Lithuania would provide data to the Commission on an annual basis in order to monitor the implementation of the regime.

B. Patent boxes

20. During the Netherlands Presidency, it was agreed to split the review process into rollback and standstill aspects.

1. Rollback

21. In November 2014 the Group agreed, in co-ordination with developments at the OECD, that the modified nexus approach is the appropriate method to ensure that patent boxes require sufficient substance. The Group agreed that the EU patent box regimes which had been subject to examination by the Group are not compatible with the modified nexus approach. As a consequence, these EU patent boxes had to be changed to put them in line with the modified nexus approach. This outcome was endorsed by the Council (ECOFIN) in December 2014.

22. The Council Conclusions of 9 December 2014 emphasised the need for Member States to start in 2015 the legislative process necessary to change the patent box regimes and asked the Group to monitor this process. Member States which currently have patent boxes needed to begin the legal processes to close the regimes to new entrants from the end of June 2016 and end all benefits for existing claimants by June 2021.

23. An updated table on the state of play of the rollback of existing patent boxes was presented by the Commission services at the meeting of the Code of Conduct Group of 20 July. It summarised the relevant information concerning four elements to be implemented by Member States:

– the cut-off date for new entrants in the existing patent box regime;

– the abolition date for the entitlement of taxpayers benefiting from an existing IP regime;

– the enhanced transparency on new entrants after 6 February 2015 – spontaneous exchange of information; and

– the grandfathering for IP assets acquired directly or indirectly from related parties after 1 January 2016.

24. The Group concluded that only France and Italy were not complying with one or more criteria.

25. At its meeting of 20 July 2017 the Group agreed to return during its meeting of September 2017 to any outstanding rollback issue, and in particular to:

(i) the effects of the Italian rollback rules regarding the cut-off date which were pointed out by several delegations as potentially harmful, and

(ii) verify if any concrete engagements were taken to roll-back the French IP box, in absence of which the Group should proceed to its assessment.

26. At the meeting on 18 September, the Commission circulated a room document updating the overview regarding the information on the rollback of Member States' old patent boxes. Italy gave some additional information relating to its IP regime, for which trademarks have been removed from the scope of the eligible assets with new entrances allowed until 31 December 2016 and possibility to maintain benefits until mid-2021 at the latest, while France indicated that an amendment of the IP regime was envisaged by the Government.

27. On 17 October 2017, France indicated that a proposal to amend its IP regime is being discussed at government level, whilst Italy announced that a new implementation decree would be adopted in the next few weeks and subsequently notified to the Code of Conduct Group.

28. On 22 November 2017, Italy announced that in the next few days, the inter-ministerial decree providing implementing provisions concerning spontaneous exchange of information on new entrants in the IP regime in relation to trademarks will be adopted.

29. The Group concluded that there was no rollback in the case of France. Concerning Italy, the new developments will be further monitored in order to assess their actual effects. Several delegations considered the effects of the Italian rollback rules regarding the cut-off date for new entrants to be potentially harmful.

2. Standstill

30. The standstill exercise relates to the assessment of patent boxes that have been notified with regard to their compliance with the nexus approach as well as all other criteria. The Commission was tasked to proceed on the basis of the descriptions from the FHTP meeting and to assess the patent boxes under all Code criteria.

31. At the meeting on 8 June, the remaining five regimes under the standstill procedure (Spain (National, Basque and Navarre), France, and Italy) were discussed by the Group. The Group agreed that the Italian regime is not harmful, considering also a declaration by the Italian delegation on the scope of the regime. While noting that substantial progress was made, the Group asked Spain to align its national and regional regimes with the modified nexus approach as soon as possible. France indicated that it could not yet make any commitment due the recent change of government.

i) France: reduced rate for long term capital gain and profits from the licensing of IP rights

32. The Commission presented an assessment of the French IP regime at the meeting on 5 April 2017 that concluded (WK 3488/2017) that the regime does not meet the third, fourth and fifth criteria and is therefore harmful. Since the regime has not been modified since 2011, it falls however within the category of those patent boxes that should have already been rolled back following the ECOFIN endorsement of the modified nexus approach in December 2014 (doc. 16553/1/14 REV 1). The related legislative process should have furthermore started in 2015 according the Council conclusions of 9 December 2014 (doc. 16846/14).

33. France has however been the only Member State not to notify to the Group any legislative step taken to that effect. On 21 September 2016, France presented a document that argued that the French IP regime tax rate of 15% does not affect in a significant way the location of business activities and that the gateway criterion of the Code should be modified. A report concluding that France is in contravention of the Council conclusions of 9 December 2014 and 8 December 2015 was submitted by the Group to the ECOFIN Council of November 2016. Since then, France did not introduce any amendments to its IP regime.

34. However, on 17 October 2017, France indicated that a proposal to amend its IP regime is being discussed at government level.

ii) Spain: national patent box regimes – Navarra – Basque Country

National IP regime:

35. Spain notified changes to its national patent box regime in May 2016. At the meeting of 24 January 2017, the Commission produced an assessment – relying on the agreed description of the OECD FHTP – that concluded (see WK 734/2017) that the regime does not meet the third criteria of the Code.

36. Following clarifications provided by Spain, the Commission provided a revised version of the draft assessment – without affecting the conclusion reached already – just to take into account the clarifications brought by Spain on the assessment under criterion 5 (doc. WK 8234/2017). In its room document, the Commission proposed to consider that the Patent box regime is in conformity with criterion 5 of the Code of Conduct but maintains that it is not respecting criterion 3. At the meeting on 22 November, Spain indicated that new legislation should be adopted at the beginning of next year in order to align its regime.

Navarra IP regime:

37. At the meeting of 24 January 2017 (see WK 688/2017), Spain also notified that Navarra has passed legislation in 2016 to adapt its patent box regime to the internationally agreed standards, but at the meeting of 5 April 2017, the Commission produced an assessment – relying on the agreed description of the OECD FHTP – that concluded (see WK 3489/2017) that the proposed measure does not meet the third criterion of the Code. At the meeting on 8 June 2017, the Group asked Spain to align its regional regimes with the modified nexus approach as soon as possible.

38. At the meeting on 20 July 2017, the Group discussed and updated version of the draft assessment – without affecting the conclusion reached already (doc. WK 8240/2017). In its room document, the Commission clarified its concerns by stating that "the only concern raised relates to the use of the specific ruling procedures within the IP regime in conjunction with a wider definition of IP assets, which might finally allow IP assets non-eligible under modified nexus-approach to benefit of the Spanish/subnational Navarra IP regime".

39. At the meeting of 17 October, Spain noted that progress was being made.

Basque IP regime:

40. At the meeting of 24 January 2017 (see WK 688/2017), Spain notified that three territories of the Basque Country (Alava, Bizkaia and Gipuzkoa) have passed legislation in 2016 to adapt their respective patent box regimes to the internationally agreed standards. At the same meeting, the Commission produced an assessment – relying on the agreed description of the OECD FHTP – that concluded however that these regimes do not meet the third and fifth criteria of the Code (see WK 707/2017).

41. At the meeting of 20 July 2017, Spain announced that all the legislation putting in line the three regimes would be passed in the near future and provided some draft laws. The Group agreed that the assessment should be positive conditional to the adoption of the law unchanged.

42. At the meeting of 17 October, Spain noted that progress was being made and, in November 2017, it notified a change of its IP regime in the Basque Country. The Commission presented a provisional assessment at the meeting on 22 November suggesting that in light of the assessments made under criteria 3 and 5 and subject to the adoption of the draft laws as communicated, the ES/Basque country regime should be considered overall not harmful. The Group endorsed this suggestion.

C. Links with third countries: Liechtenstein

43. Following a recommendation by the Code of Conduct Group, the ECOFIN Council in its conclusions of 8 June 2010 invited the Commission to start a dialogue with Liechtenstein on the application of the principles and criteria of the Code on identified potentially harmful regimes.

44. Following an exchange of views in the Code of Conduct Group on the state of play of this dialogue at the meetings of 2 June and 21 September 2016, it was agreed to invite Liechtenstein to a forthcoming meeting. At its meeting on 5 April 2017, the Code of Conduct Group reiterated interest in resuming the discussion with Liechtenstein on the following identified potentially harmful regimes:

    1. the full exemption for dividends and capital gains on participations ;
    2. the exemption for capital gains combined with a tax deductible write down/value adjustment ;
    3. the special regime for Private Asset Structures (PAS) ;
    4. the Liechtenstein royalty box; and
    5. the Liechtenstein notional interest deduction regime;

45. On 15 May 2017, the Commission circulated an agreed description relating to three regimes concerned, as the royalty box has been repealed: exemption for dividends, exemption for capital gains, the Private Asset Structure, and the notional interest deduction regime. Against this background, the Liechtenstein authorities were invited to the meeting of the Code of Conduct Group on 8 June and gave a presentation on the state of play and the way forward from the Liechtenstein perspective with regard to the regimes concerned.

46. The Commission circulated an assessment of the remaining 3 regimes still under consideration. The Liechtenstein authorities were invited to the meeting of the Code of Conduct Group on 17 October 2017 and gave a presentation on the state of play from the Liechtenstein perspective with regard to the regimes concerned.

47. On the basis of the Commission's assessment, the Group decided that the tax exempt corporate Income-dividends and capital gains regime (LIE001) and the interest deduction on equity (allowance for corporate equity – ACE) (LIE003) were harmful; and that the Private asset Structures (PAS) (LIE002) was out of the scope of the mandate of the Code of Conduct as it does not apply in practice to business activities.

48. Liechtenstein committed to provide data in relation to the PAS regime. On 22 November 2017, the Commission services confirmed that they had received these elements and the Group confirmed its previous assessment.

IV. Process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes

49. The ECOFIN Council, in its Conclusions of 25 May 2016 on an "External Strategy for Effective Taxation and Commission Recommendation on the implementation of measures against tax treaty abuse" invited "*the Code of Conduct Group to start work [...], with a view to establishing an EU list of non-cooperative jurisdictions and exploring defensive measures at EU level to be endorsed by the Council in 2017. Those defensive measures could be considered to be implemented in the tax as well as in the non-tax area*."[1].

50. In its 8 November 2016 Conclusions[2] the Council set out the criteria on tax transparency, fair taxation and implementation of anti-BEPS standards, as well as the guidelines for the process of screening jurisdictions with a view to establishing an EU list of non-cooperative jurisdictions for tax purposes.

51. Since then, the Code of Conduct Group (Business Taxation) (COCG) and Council Presidency, chairing the COCG subgroup on third countries[3], have worked intensely on this dossier.

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[1] Doc. 9452/16 FISC 85 ECOFIN 502, point 10.

[2] The official publication of these Council Conclusions can be found in the *Official Journal of the European Union*: OJ C 461, 10.12.2016, page 2.

[3] Doc. 6674/16 FISC 33 ECOFIN 189.

52. The COCG, in line with the mandate (the Guidelines[4]) by the Council, finalised the preparatory work, launched an assessment ("screening") exercise on a number of jurisdictions on the basis of the Commission's Scoreboard, and invited these jurisdictions to engage in the process of analysis of their tax systems against the criteria, set out in the Council conclusions of 8 November 2016, concerning the areas of tax transparency, fair taxation and implementation of anti-Base Erosion and Profit Shifting (anti-BEPS) measures.

53. Technical analysis was conducted by the experts appointed by the COCG, on the basis of the publically available sources as well as information provided by the jurisdictions concerned, as most of the jurisdictions chose to engage in this process.

54. At its meeting of 17 October 2017 the COCG considered the outcome of this analysis[5] and agreed that letters, drafted on the basis of the templates agreed by the COCG and signed by the Chair of the COCG, should be sent to all jurisdictions concerned, informing them of the results of this work and, where relevant, seeking high level political commitment from the jurisdictions to address the identified concerns.[6]

55. Notably, an important part of the work of COCG evolved around the screening criterion 2.2 ("*the jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction*."). The scope of this criterion was further specified by the COCG, as mandated by the Council, specifically on how the absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero by a jurisdiction should be assessed, while the Council has also agreed that the absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero cannot alone be a reason for concluding that a jurisdiction does not meet the requirements of criterion 2.2.

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[4] See doc. 14166/16, point 7 of the "Guidelines for the process of screening of jurisdictions with a view to establishing an EU list of non-cooperative jurisdictions for tax purposes" (as endorsed by ECOFIN of 8 November 2017)

[5] Doc. 12831/17 EU RESTRICTED; doc. 12939/17 EU RESTRICTED; doc. 13015/17 EU RESTRICTED; doc. 13182/17 EU RESTRICTED; doc. 13235/17 EU RESTRICTED.

[6] The relevant parts of these letters sent out to jurisdictions, setting out the commitments sought by the Code of Conduct Group are reproduced in the Annex I to doc. 13890/17 EU RESTRICTED.

56. Jurisdictions where concerns with regard to criterion 2.2 were determined, were invited to discuss with the COCG what further steps could be taken to address the concerns that were identified and in particular to ensure that businesses have sufficient economic substance.

57. The COCG agreed to put on hold the screening process to the jurisdictions that were affected by natural disasters. Nevertheless, these jurisdictions will be asked to address the concerns identified as soon as the situation improves, with the view to resolving these concerns by the end of 2018. By February 2018, the COCG will therefore contact these jurisdictions to prepare the next steps of co-operation.

58. The COCG also took as a basis the work carried out by the Presidency, chairing the COCG Subgroup on third countries, on the draft of the Council conclusions on the EU list of non-cooperative jurisdictions for tax purposes, which provided the framework for setting out the EU list, the defensive measures in tax and non-tax area, as well as outlined the principal aspects of further work on how the commitments of jurisdictions to comply with the screening criteria should be monitored.

59. On this basis, following a balanced review of all information collected in the screening process, the COCG reported to the Council.

60. As requested by the Council[7], the report of the COCG contained the draft Council conclusions on the EU list of non-cooperative jurisdictions for tax purposes and the recommendations of the COCG on those jurisdictions that do not comply with the screening criteria which, in the view of the COCG, the Council would decide by consensus, as appropriate, to include in the list of non-cooperative jurisdictions.

[7] Doc. 10397/17 FISC 141 ECOFIN 551 CO EUR-PREP 32, paragraph 90.

61. The dialogue with relevant jurisdictions to promote tax transparency, fair taxation and implementation of anti-BEPS standards and the process of promoting the standards in the areas of tax transparency, fair taxation and implementation of anti-Base Erosion and Profit Shifting (anti-BEPS) measures will continue and the COCG will act in co-ordination with the work of the Global Forum on Transparency and Exchange of Information for tax Purposes, and the OECD Inclusive Framework on Base Erosion and Profit Shifting, in particular the Forum on Harmful tax Practices.

V. <u>Procedural issues</u>

1. <u>Clarification of the third and fourth criteria</u>

62. The Council conclusions of December 2015 on the future of the Code of Conduct (doc. 15148/15, paragraphs 12-13) invited the Group to "*clarify the third criterion by developing guidance on the basis of OECD BEPS conclusions on Action 5*" and "*the fourth criterion by developing guidance in the light of the OECD Transfer Pricing Guidelines, as amended by OECD BEPS conclusions on Actions 8-9-10*".

63. The Work Package 2015 underlined that "*the Group will develop guidelines covering (...) the interpretation of criterion 3, focussing on the application of a nexus approach to preferential regimes other than patent boxes (...) [and] the interpretation of criterion 4, focussing on which internationally agreed standards are relevant and the role of the arm's length principle in identifying potentially harmful measures*".

64. The Council conclusions of March 2016 (doc. 6900/16, paragraph 10) supported the creation of the new subgroup to deal with the clarification of the interpretation of Code's criteria 3 and 4: "*The Council (...) DECIDES that a subgroup will deal with the clarification of the third and the fourth criteria of the Code*". At the meeting on 20 July 2016 the Group confirmed this mandate and requested the new Subgroup to prepare Council conclusions on this issue.

65. The Code of Conduct Group agreed in November 2016 to consider reviewing and updating the guidance on tax privileges related to special economic zones on which consensus was reached within the Code of Conduct Group in March 2013, in the light of the new interpretation of criterion 3. A compromise was agreed by the Code of Conduct Group on 8 June and endorsed by ECOFIN on 16 June.

66. The application of the principles of the modified nexus approach to non-IP regimes was discussed during the Maltese Presidency, but views of delegations were split on whether to postpone the development of CoC group guidance on all types of regimes until the availability of similar guidance by the OECD Forum on Harmful Tax Practices (FHTP).

67. Another element of discussion was the clarification of the distinction between the real economic activity test and the substantial economic presence test within the existing drafting of the third criterion. It was agreed to clarify this distinction and against this background, a proposal for a guidance on the interpretation of the third criterion was tabled by the Commission services at the subgroup meeting of 19 July 2017.

68. The OECD FHTP meeting of 3-11 July 2017 having agreed a note on "Substantial activities in regimes other than IP regimes", the subgroup decided to adjust the previously mentioned guidance on the interpretation of the third criterion accordingly. A revised guidance proposal was in this respect tabled by the Commission services at the subgroup meeting of 30 October. On this basis, the Estonian Presidency tabled a compromise text at the subgroup meeting of 16 November 2017. Further work will be required on this matter.

69. The Code of Conduct Group having also agreed in November 2016 to develop guidelines with regard to the use of internationally agreed principles for interpreting the fourth criterion other than those enshrined in OECD Transfer Pricing Guidelines, the Commission services put forward a list of potentially relevant internationally accepted principles with a preliminary guidance note for each of them at the subgroup meeting of 24 February 2017. On this basis, the Maltese Presidency tabled a consolidated draft guidance on the interpretation of the fourth criterion at the subgroup meeting on 3 April 2017, then allowing the Estonian Presidency to tabled draft compromise texts at the subgroup meetings of 19 July and 30 October 2017. A final compromise was reached at the subgroup meeting of 16 November 2017 and agreed by the Code of Conduct Group on 22 November 2017 (see Annex I).

2. Guidelines setting working methods for an effective monitoring of Member States' compliance with agreed guidance

70. The 2015 Work package states that in order to improve its working practices the Group will develop guidelines covering the monitoring of Member States' compliance with existing guidance or other standards agreed by the Group. The Group discussed this issue on 18 September 2017 on the basis of a document from the Commission services.

71. In the light of the comments made by Member States, the Commission services presented a revised document which was discussed by the Group on 17 October 2017. At this meeting, the group reached consensus on the draft guidelines (see Annex II).

ANNEX I

Guidance on the interpretation of the fourth criterion of the Code of Conduct for business taxation

1. Purpose of the Guidance

The guidance set out below is based on past decisions of the Code of Conduct Group and is intended to improve the transparency of the Code of Conduct Group's work. It is also intended to help Member States as well as third countries identify more easily potentially harmful tax measures.

The guidance neither replaces the principles and criteria of the Code of Conduct nor prejudges the harmfulness of any particular regime. The guidance presents a non-exhaustive list of elements and characteristics which indicate that a tax measure may be harmful when fully assessed against the criteria in the Code of Conduct. Every assessment will continue to be based on the five criteria of the Code of Conduct on a case-by-case approach.

The purpose of the text is to provide guidance on the application of the criteria in the Code of Conduct but it does not go beyond those criteria nor does it limit them. The guidance can never provide a safe harbour for a particular regime. A tax measure that is the object of particular scrutiny or that requires particular attention under the guidance may be found non-harmful by the Code of Conduct Group; likewise a measure that is not the object of particular scrutiny or that does not require particular attention under the guidance may be found to be harmful when assessed by the Group.

The purpose of the guidance is not to confine the Group to applying pre-determined general criteria; rather it should continue to subject each particular regime to a case-by-case examination against the Code of Conduct criteria in the light of the Group's guiding principles set out in document 16410/08 FISC 174.

2. Relationship with past assessments

Regimes for which the Group has agreed before this guidance enters into force that there was no need to assess them or that have been assessed as not potentially harmful, will not be affected by this guidance. The current procedure for reopening past assessments remains in place.

3. Review of the Guidance

The countering of harmful tax measures is an ongoing process; therefore the present guidance may be periodically reviewed by the Code of Conduct Group to ensure that it reflects future developments.

4. Guidance

Preferential business taxation measures will be the object of particular scrutiny by the Code of Conduct Group (business taxation) when interpreting the fourth criterion if one or more of the following circumstances are met:

1. The measure deviates from the arm's length principle as applied in accordance with the most recent update of the OECD Transfer Pricing Guidelines for profit determination, unless

    a. this deviation is proportionate and justified with reference to the size of the SMEs as defined in the Commission Recommendation 2003/361/EC, or

    b. the measure uses "safe harbour" rules for profit determination that are proportionate and justified with reference to the reduction of the administrative burden which the measure is expected to produce.

2. The measure provides for a reduction of the tax base by a specific percentage. However, a reduction in the tax base should not be considered as falling within the scope of the fourth criterion in any specific case where it results that:

   - the tax base before the fixed reduction has been calculated in accordance with the arm's length principle, and

   - the reduction leads to the same result as a reduced tax rate, and

   - the reduction leads to a simplification of tax administration.

3. The measure deviates from the principle that the profits to be attributed to a permanent establishment (PE) are the profits that the PE would have earned at arm’s length, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise, regardless of the OECD approach chosen;

4. The measure deviates from the minimum standard committed to under OECD BEPS;

5. The measure allows a deduction for costs or losses that is not symmetrical to the determination of the taxable earnings.

ANNEX II

Procedural Issues:

Guidelines on setting working methods for an effective monitoring of Member States' compliance with agreed guidance

Introduction

1. This note provides guidelines to the Code of Conduct Group ("the Group") regarding the working methods to follow in order to ensure an effective monitoring of Member States' compliance with *agreed guidance*, *guidelines* or *any other standards agreed by the Group* (hereafter referred to as 'agreed guidance").

2. It deals with the:

   - Scope of the monitoring;
   - Procedure for choosing the priority order in which the agreed guidance will be monitored;
   - Monitoring process;
   - Way the results of the monitoring are followed-up [rollback process];
   - Way the results of the monitoring process are publicised [transparency of the outcome of the monitoring].

Scope of the monitoring

3. During its monitoring exercises the Group shall verify Member States' compliance with agreed guidance. The monitoring shall verify in one horizontal exercise the compliance by all Member States.

4. The monitoring shall conclude if national provisions or practices ("national provisions") are "compliant" or "(partly) non-compliant" with the agreed guidance being monitored.

5. As soon as guidance is agreed by the Group, Member States must amend their national provisions to comply with the guidance within a reasonable timeframe, and at the latest within two years from its adoption, unless a different timeline is explicitly indicated by the guidance itself.

6. Monitoring Member States' compliance with agreed guidance shall thus verify whether national provisions *in force at the time of the monitoring* are in line with the agreed guidance being monitored.

Procedure for choosing the priority order in which the agreed guidance will be monitored

7. As a rule the Group shall, when adopting its Work Package (Work Program), decide on a priority list of agreed guidance to be monitored during the relevant period.

8. When setting the aforementioned priority list, the Group shall take account of circumstances such as i) the fact that Member States should be allowed reasonable time and at most two years to amend their laws or practices in order to comply with the relevant guidance, unless a different specific timeframe is provided by the guidance itself; ii) the political sensitivity of the guidance; iii) any other circumstance it considers relevant.

9. The Group may decide to expand the priority list, change the priority order or replace some of the topics initially chosen for monitoring. This may happen if during an ongoing Work Program other topics for example are considered more sensitive, or their immediate monitoring is needed, for example due to developments at the international level.

10. When implementing the priority list, the workload involved should be taken into account and as a principle only one guidance should be monitored at a time.

Monitoring process regarding compliance with agreed guidance

Reporting phase

11. First, the Group shall make an inventory of the relevant national provisions aiming at complying with the agreed guidance being monitored. To this end, the Group shall invite Member States to communicate their relevant national provisions.

12. The reporting shall be done preferably, and to the extent possible, by answering a questionnaire or checklist previously prepared by the Commission services and approved by the Group.

13. If it is not possible to follow the approach of a questionnaire/checklist because of the specificity of the guidance being monitored, a global (wider) reporting approach can be considered.

14. Regardless of the approach followed, the Group may decide whether a different weight is to be attached to the obligations stemming from the agreed guidance, according to their importance[8] and/or nature[9]. This shall be done upon approval of the questionnaire/checklist, or when the decision to follow a global (wider) reporting approach is made.

15. The Member States shall provide the information in an open and transparent manner and within the agreed deadlines. As regards the quality and accuracy of the information to be provided, Member States are reminded of the note agreed by the Group on *Guidance on the provision of information in the review process*[10].

16. Based on the information received, the Commission shall prepare an overview of the national provisions communicated.

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[8] E.g. principal, secondary or auxiliary obligations

[9] E.g. substantive, procedural, reporting obligations

[10] Annex 2 to ANNEX II) doc 14750/16, FISC 202

Reviewing phase

17. The reviewing phase starts with a preliminary assessment by the Commission of the compliance by each Member State with the agreed guidance being monitored.

18. The review process undertaken by the Group shall aim at ensuring a structured and consistent horizontal verification of the national provisions concerned. In order to conclude if national provisions are "compliant", "partly non-compliant" or "non-compliant" with the agreed guidance being monitored, the Group shall endeavour to apply a coherent and equal assessment, in light also of the *General guiding principles concerning evaluation of measures*[11].

19. To this purpose and given the specificities of the individual agreed guidance, the assessment approach followed by the Group may differ. Where appropriate, the Group shall take into account the weight attached to the obligations complied with (or not) among all the obligations imposed by the agreed guidance, in order to reach a conclusion regarding the compliance by each Member State with the agreed guidance being monitored.

20. The Group shall do its best to complete this reviewing phase within two to three meetings.

Monitoring the follow-up of the results

21. The Member States whose national provisions are assessed by the Group as "partly non-compliant" or "non-compliant" with the agreed guidance should rollback their laws or practices, in order to comply with the relevant guidance.

22. As a general rule, two years should be sufficient for rollback, unless a different deadline is agreed by the Group in the view of the specificity of the agreed guidance being monitored.

23. The Member States concerned shall inform regularly and at least once during each Presidency period of the state of play of the national provisions adopted or planned for adoption in order to roll back the national provisions assessed as "non-compliant" or "partly non-compliant".

24. In addition, and depending on the obligations set in the agreed guidance being monitored and failed to comply with, the Group may decide whether the national provisions assessed as "non-compliant" or "partly non-compliant" also constitute a national measure that otherwise is worth assessing separately against the Code criteria to conclude on its harmfulness or lack thereof.

25. The review process in the present Guidelines does not impact in any way the standard review process of tax measures set down in the Council Conclusions of 1 December 1997 establishing the Code of Conduct.

26. Furthermore, it is recalled that the *'General guiding principles concerning evaluation of measures'*, agreed by the Group in November 2008 (doc. 16410/08, FISC 174) remains unchanged and will not be affected by the present Guidelines.

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[11] General guiding principles concerning evaluation of measures' agreed by the Group in November 2008 (doc. 16410/08 FISC 174).

Transparency regarding the results of the monitoring process

27. In addition to the general report at the end of each Presidency reflecting the progress made during a specific monitoring exercise, every time a monitoring exercise is finalized, the Group shall report the results to the Council. A monitoring exercise is considered finalized when the Group will have assessed ("compliant", "partly non-compliant" or "non-compliant") all Member States' relevant provisions in respect of a particular agreed guidance.

28. Such final report may comprise:

    - the names of the Member States having complied with the agreed guidance, but also the name of those having failed to comply with the agreed guidance (assessed as "partly non-compliant' or "non-compliant") [if appropriate, accompanied by a summary explanation];
    - the deadline for rollback obligations.