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REPORT

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

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 December 2015 (doc. 15148/15), 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 first half of 2017 under the Maltese Presidency.

II. General aspects

7. The Code of Conduct Group met three times under the Maltese Presidency, on 25 January, 5 April and 8 June 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 25 January, in line with the work package, the Group decided to focus work during the Maltese Presidency on the following items:

- Continuation of the work on the establishment of the EU list of non-cooperative jurisdictions.
- Continuation of the work on outbound payments.
- 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 especially regarding the various measures that are recommended to replace existing regimes.
- Continuation of the work regarding the clarifications of the third and fourth criteria.
- Monitoring developments in the administrative practices of Member States.
- Monitoring of Member States' compliance with existing guidance or other standards agreed by the Group.

2. Appointment of the Chair person

9. Since the two-year period for which Dr Wolfgang Nolz was appointed as Chair of the Code of Conduct Group expired on 4 February 2017, the appointment of the future Chair was on the agenda of the meeting of the Code Group on 25 January 2017.

10. The procedure for appointment of the Chair is set out in the Council conclusions of 9 March 1998 concerning the establishment of the Code of Conduct Group (Business Taxation) (doc. 6619/98), which provides in paragraph 5 that:

"*... the chairman will be appointed by common accord, but [...], if necessary, the chairman shall be elected by a majority of the high-level representatives of the Group*".

11. At the Code of Conduct Group meeting on 25 January 2017, on the basis of the voting procedure set out by the General Secretariat of the Council, Ms Fabrizia Lapecorella, Director General of Finance of the Ministry of Economy and Finance (Italy) was appointed as Chair of the Code of Conduct Group for a period of two years, starting on 5 February 2017.

3. Appointment of Vice-Chairs

12. Antoine Fiott-Grima (Malta) and Elo Madiste (Estonia) were confirmed as respectively the first and the second Vice-Chairs for the period up to the end of the Maltese Presidency.

III. Standstill and rollback

A. Standstill

13. At the meeting on 25 January, the Commission services informed the Group that six Member States had notified new measures on standstill for the year 2016: Croatia, the Netherlands, Latvia, Lithuania, Luxembourg and Poland.

1. Croatia

14. 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.

15. As clarification was needed on some aspects of those measures, it was agreed that the Commission services would follow up on those issues bilaterally with the Member State concerned and report back to the Group at the earliest opportunity.

16. At the meeting on 25 January, 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. At the meeting on 5 April, Croatia announced that some amendments to the regime would be introduced soon. The Group decided that the Commission services should agree on the substantial changes proposed and come back to the Group with the assessment as soon as possible.

17. At the meeting on 8 June 2017, Croatia confirmed that a new legislation would be sent to Parliament for adoption by the end of June and the Group agreed that this issue should be discussed at the next meeting on the basis of an assessment by the Commission services.

2. Aruba (Netherlands)

18. 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.

19. At the meeting on 8 June 2017, the Netherlands informed the Group 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.

3. Latvia

20. In November 2016, the Latvia's Parliament adopted a new Law on support for start-ups activities (start-up reliefs) aiming at stimulating formation of start-ups in Latvia, thereby contributing to research as well as innovative ideas, products or processes. At the meeting on 5 April, the Commission services indicated that there were still questions to discuss bilaterally with Latvia.

21. At the meeting on 8 June 2017, the Group agreed that the discussion on this measure, taking into account its *de minimis* dimension, would not be pursued further.

4. Lithuania

22. 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). At the meeting on 5 April, the Commission services indicated that there were still questions to clarify bilaterally with Lithuania.

23. 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. As regards this possible IP component, Lithuania is however of the view that its regime does not specifically provide for preferential treatment of IP income.

5. Luxembourg

24. A circular issued by the Luxembourg Tax Administration further aligned the tax treatment of companies engaged in intra-group financing activities to the recently revised OECD Transfer Pricing Guidelines (Action 8-10 of the BEPS Action Plan). The Luxembourg measure was not assessed as it does not seem to entail any risk in the light of the Code of Conduct criteria. Luxembourg wrote to the Chair and the Commission Services on 24 May 2017 to express its commitment to spontaneously exchange information in the instances provided by the circular (i.e. when the taxpayer makes use of the safe harbour rule), and also in instances where a taxpayer would apply the 2% net return on financial assets in his commercial accounts and would then apply, based on a transfer pricing analysis, a downward adjustment in the tax return in order to achieve an at arm's length remuneration.

6. Poland

25. Poland adopted on 6 July 2016 an Act on activation of the shipbuilding and complementary industries providing for the possibility of choice, under certain conditions, of the 1% flat rate tax on the value of the marketed production related to ship building and ship conversion. On 5 April 2017, the Group noted that the measures are related to shipping industry and are therefore outside the scope of the Code of Conduct.

B. Patent boxes

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

1. Rollback

27. 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.

28. 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.

29. 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 25 January. 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.

30. The Group concluded that only France, Spain (for some subnational regimes) and Italy were not complying with one or more criteria.

31. At the meeting on 5 April, Italy announced that the government was about to present an amendment of the IP Regime in order to put it in line with the nexus approach and committed to submit to the Code of Conduct Group the amended regime for assessment. Spain, at the same meeting, updated the Group underlying that the government was working on a proposal aiming at amending the regime, which will be submitted soon to the Parliament. France regretted that its IP regime was considered harmful and indicated that it had not taken a definitive position on the future of the regime with regard to the modified nexus approach issue.

32. At the meeting on 8 June 2017, the Group discussed the issue on the basis of updated information given by Italy and Spain and noted that further progress had been made on the rollback of their IP regimes. France reiterated its position on the rollback of its regime.

33. Italy agreed to provide relevant statistical information with a view to further axamining the possible impact of the grandfathering provisions.

2. Standstill

34. Regarding the standstill procedure, it was decided that the OECD descriptions would be used and the measures would be assessed on the basis of the modified nexus approach and against all Code criteria.

35. 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.

36. At the meeting of 25 January, it was noted that eleven (of the twelve) regimes had been assessed and the Commission services pointed out two issues which had complicated its assessment: the lack of availability of data and statistics because the regimes are new and the interpretation to give to criterion 4 in the light of the work of the subgroup on the clarification of the third and fourth criteria (see below).

37. At the meeting of 5 April, all twelve regimes were now on the table as Belgium's regime has since been adopted. It was agreed that the Netherlands delegation would circulate an explanatory document clarifying the aspects relating to the "connected IP" of the IP regime of the Netherlands. Following the circulation of this document (see Annex 1) and a silence procedure that ended on 28 April, the Code of Conduct Group agreed that the IP regimes of Belgium, Cyprus, Hungary, Ireland, Portugal, the United Kingdom and the Netherlands are not harmful.

38. 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 (see Annex 2). 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.

C. Links with third countries

1. Liechtenstein

39. The dialogue with Liechtenstein was re-opened in 2015 following agreement in the Code of Conduct Group at the meeting of 22 October 2014.

40. Following the presentation made by Liechtenstein at the meeting of the Code of Conduct Group on 21 October 2015 and the ensuing exchange of views between Member States, the Commission services were asked to provide a preliminary analysis of the compatibility of the Liechtenstein measures at issue with the Code of Conduct.

41. The preliminary analysis was presented at the meeting of November 2015 and Member State delegations agreed that this was a good basis for continuing the dialogue with Liechtenstein. It was also decided to suggest to Liechtenstein to add a discussion on rulings to the dialogue.

42. Contacts with the Liechtenstein authorities took place on a number of occasions in 2016 and 2017.

43. Liechtenstein authorities were invited in the margin of the meeting of the Code of Conduct Group on 8 June 2017 to give a state of play on this issue and to answer questions of Member States on the way forward. The Group discussed the relevance of the identified regimes with respect to the scope of the Code of Conduct and agreed to move to the assessment phase for all these regimes except for the IP box which has been repealed in 2016.

2. Switzerland

44. According to the 2015 Work Programme, the Group will monitor the outcome of past dialogues with third countries. On 5 April 2017, the Chair updated delegates on recent developments in Swiss corporate tax policy, in order to monitor the implementation of the EU-Switzerland Joint statement.

45. The Joint statement which was signed on 14 October 2014 contained the following engagements made by Switzerland:

"*The Swiss Federal Council intends to take measures to remove the following five tax regimes (subject to approval by the appropriate legislators where necessary):*

- *the cantonal administrative company status;*
- *the cantonal mixed company status;*
- *the cantonal holding company status;*
- *Circular Number 8 of the Federal Tax Administration on principal structures; and*
- *the current practice of the Federal Tax Administration regarding finance branches.*

Moreover, the Swiss Federal Council has expressed an intention that any possible replacement measures will need to be in line with generally accepted international standards as referred to in paragraph 2.II above."

46. On 17 June 2016, the Swiss parliament approved the Corporate Tax Reform Act. The said tax reform would remove the regimes covered by the Joint statement. However, in a referendum held on 12 February 2017 the Swiss people rejected the Corporate Tax Reform Act. As a result the whole act including the provisions removing the identified tax regimes will have to be replaced by a new proposal from the Swiss government.

47. A letter sent to the Chair of the Code of Conduct on 30 March 2017 confirmed that the Swiss authorities have committed to including the removal of the five regimes in a new legislative proposal.

48. The Swiss authorities were invited in the margin of the meeting of the Code of Conduct Group on 8 June 2017 to give a state of play on this issue and to answer questions of Member States on the way forward. The Group agreed to monitor the developments of the legislative process leading to a new tax reform in line with the joint statement of 14 October 2014.

3. <u>Tax good governance clause</u>

49. In its Conclusions on an external taxation strategy and measures against treaty abuse from 25 May 2016 (doc. 9452/16 FISC 85) the Council also supported "*the need to update the principles of tax good governance to be used as the new standard provision in future negotiations with third countries*" and invited the Code of Conduct Group "*to examine key elements which should be contained in a clause to be inserted in agreements between the EU and those countries*".

50. In its meeting on 20 July 2016 the Group agreed that Code of Conduct subgroup on third countries should deal with this issue. The subgroup held initial discussions on this issue on 14 September 2016.

51. The subgroup on third countries discussed the issue on 18 May 2017 on a basis of a proposed text. Delegations largely supported the latter, subject to some clarifications. It was underlined that the provision should set up some common criteria to be respected but, at the same time, be flexible enough to adapt to all countries, in particular developing countries. It was concluded that further work will be undertaken on this issue.

IV. <u>Anti-abuse issues related to outbound payments</u>

52. The Code of Conduct Group agreed in July 2009 "*to the establishment of a sub-group of the CoC Group to examine, with the view of establishing guidelines, anti-abuse issues related to inbound and outbound profit transfers and mismatches between tax systems, in particular as regards the treatment of hybrid entities and profit participating loans*" (doc. 11967/09).

53. This anti-abuse subgroup started by developing guidelines on profit participating loans (doc. 10033/10) and inbound profit transfers (doc. 16766/10), which were respectively agreed by the Group on 25 May and 22 November 2010. In 2011-2012, the subgroup then discussed the legal implications of different possible ways to implement the solution foreseen in the CoC Group guidance on profit participating loans, and asked for support by the Commission on this issue. This led to the proposal for revising the Parent-Subsidiary Directive (PSD), which was adopted by the Council in July 2014.

54. Starting from 2012, the subgroup focused its attention and work on the issue of hybrid mismatches between tax systems, resulting in the endorsement by ECOFIN of four guidance notes between 2014 and 2016 on hybrid entity and permanent establishment mismatches between Member States and with third countries. At its meeting on 20 July 2016, the CoC Group agreed that further work of the subgroup on this topic was not required considering that the Commission proposal for a Council Directive amending Directive (EU) 2016/1164 ("ATAD 1") as regards hybrid mismatches with third countries ("ATAD 2") covered the hybrid mismatches that were included within the subgroup's mandate (doc. 14750/16).

55. The last remaining issue falling within the mandate of the subgroup is therefore the question of outbound payments, also included in the Work Package of November 2015 (doc. 14302/15). The issue was discussed at the level of the Code of Conduct Group at its meetings of 12 April, 20 July, 21 September and 19 October 2016 but no agreement could be reached.

56. At the CoC Group meeting of 5 April 2017, the new chair indicated that the issue of outbound payments was among her priorities for this year and invited the subgroup on anti-abuse issues to restart work on this matter.

57. At the subgroup meeting of 18 May, a preliminary draft of possible guidance was discussed with Member States, which proposed to follow the same flexible "toolbox approach" as already used for past guidelines (e.g. on inbound payments) and suggested a link with the EU listing of non-cooperative jurisdictions. Member States rejected this proposal and expressed different perspectives on the way forward. Member States agreed that the issue should be dealt with again in due course when new data on effectiveness of anti-abuse measures in EU directives have become available.

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

1. General remarks

58. Part of the conclusions on an external taxation strategy and measures against tax treaty abuse prepared by the HLWP and adopted by ECOFIN on 25 May 2016, states that the Council "*agrees on the establishment by the Council of an EU list of third country non-cooperative jurisdictions and to explore coordinated defensive measures at EU level without prejudice to Member State competence*"[1].

59. In its 8 November 2016 Conclusions the Council set out the criteria and guidelines for the process of screening jurisdictions with a view to establishing an EU list of non-cooperative jurisdictions for tax purposes. The Council resolved that "*the Code of Conduct Group (Business Taxation), supported by the General Secretariat of the Council, will conduct and oversee the screening process. The European Commission services will assist the Code of Conduct Group (Business Taxation) by carrying out the necessary preparatory work for the screening process in accordance with the roles as currently defined under the Code of Conduct for Business Taxation process, with particular reference to previous and ongoing dialogues with third countries.*"[2]

60. The Code of Conduct Group was also tasked by the Council with the following:

a) to finalise its work on the selection of jurisdictions for screening on the basis of the European Commission's Scoreboard;

b) to define, based on objective criteria, the duration of the reasonable timeframe, referred to in criterion 1.3;

c) to define the scope of application of criterion 2.2 and to evaluate, in the context of criterion 2.2, the absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero as a possible indicator;

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1 See doc. 9452/16, point 6.

2 See doc. 14166/16, point 2 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".

d) to further develop the appropriate arrangements on the practical methods and modalities on implementing the screening guidelines with a view to effective implementation of the screening process of jurisdictions with a view to the establishment by the Council of an EU list of non-cooperative jurisdictions for tax purposes;

e) to continue exploring defensive measures at EU level to be endorsed by the Council, in line with the Council Conclusions of May 2016.

2. <u>Preparatory work</u>

61. Preparatory work referred to in point 59(a) to 59(d) above, which was required for launching the assessment exercise, was carried out, in line with the request and the guidelines set by the Council.

62. In November 2016, the Code of Conduct Group concluded work on the selection of jurisdictions for screening, which were contacted at the end of January 2017, in accordance with the mandate set out in 8 November 2016 Council conclusions.

63. The Council, in its meeting of February 2017 endorsed the text further defining the duration of the reasonable timeframe, referred to in criterion 1.3 (as agreed by the Code of Conduct Group in December 2016), as well as the text on the scope of application of criterion 2.2[3]. The latter clarification was also a result of the discussions on evaluation, in the context of criterion 2.2, of the absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero as a possible indicator.

64. During the first quarter of 2017, with a view to the effective implementation of the screening process, the Code of Conduct Group has also elaborated further practical arrangements for the screening process in 2017. Among other issues, as requested by the Council, the Code of Conduct Group addressed the issue that during the screening process particular account should be taken of the fact that developing countries (provided that they do not rank high in terms of financial activity and do not have financial centres) may lack the capacity to implement the tax transparency standards and anti-BEPS minimum standards according to the same timeline as developed countries.

[3] See doc. 6325/17, Annex I and Annex II.

65. The Code of Conduct Group mandated the Chair to liaise with representatives of the relevant international fora (Chairs of Global Forum on Transparency and Exchange of Information, Inclusive Framework on BEPS and Forum on Harmful Tax Practices; OECD secretariat). The Chair, supported by the General Secretariat of the Council and the Commission, has taken up contacts in order to ensure that work in this area should "be coordinated with and build on the developments in the Global Forum on Transparency and Exchange of Information for Tax Purposes and the OECD Inclusive Framework for Tackling Base Erosion and Profit Shifting", as requested in the Council conclusions of 8 November 2016.

66. In conducting and overseeing the screening process, the Code of Conduct Group will continue, where relevant, to refine, based on objective criteria, further practical arrangements to give effect to the November 2016 ECOFIN Council Conclusions.

3. **Discussion on options for defensive measures**

67. In its May 2016 conclusions, ECOFIN Council 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*;".

68. In November 2016, while endorsing the criteria for and the process leading to the establishment of the future EU list of non-cooperative jurisdictions for tax purposes, ECOFIN Council reiterated the need to "[…] *continue exploring defensive measures at EU level to be endorsed by the Council, in line with the Council Conclusions of May 2016*."

69. The Council also stated that "*the work on exploring defensive measures at EU level in line with the Council Conclusions of May 2016 should be completed in due time. Any defensive measures should be without prejudice to the respective spheres of competence of the Member States, such as to apply additional measures or maintain lists of non-cooperative jurisdictions at national level of a broader scope*."

70. During the term of the Maltese Presidency, exploratory work on possible defensive measures in tax and non-tax area was being carried out at the meetings of the Code of Conduct Group (Business Taxation) subgroup on third countries[4].

71. As a starting point, all delegations agree that presence on a list of non-cooperative jurisdictions common to EU Member States could be regarded as a dissuasive defensive measure in itself, causing, primarily, reputational damage and the risk to face tax consequences at national level.

72. As far as any further EU-level defensive measures in tax area are concerned, the subgroup considered broad categories of defensive measures that are already applied by Member States. The most common types of measures identified so far, that could be explored further, seem to fall under the following general headings:

a) Non deductibility of costs;
b) CFC rules;
c) Withholding tax measures;
d) Participation exemption limitation;
e) Tax reporting/disclosure requirements;
f) Rebuttable presumptions (burden of proof).

73. Exploring these categories further might permit determining more specific defensive measures that could be suitable to be implemented and the possible level of coordination achievable thereof. The future solution should be compatible with specifics of national legal and constitutional order of all EU Member States. In this context, all Member States converge on the principles that any further co-ordinated defensive measures (if such are agreed to be taken at EU level) should:

a) send a strong political signal to the listed jurisdictions;

b) be effective, dissuasive and proportionate;

c) be straightforward and easy to administrate.

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

74. It is to be noted, however, that before the debate on any specific defensive measures and co-ordination thereof could be concluded, certain important constitutive parts of the "listing" process need to be clarified further, such as conditions for de-listing, mechanism for continuous monitoring of the situation and regular updates to the list.

75. While exploring options for defensive measures in non-tax area, delegations took note of the ongoing negotiations on a number of EU legislative files, where, in certain provisions, a link with the future common list of non-cooperative jurisdictions could be designed, if an agreement on a compromise text is reached by all parties to negotiations in the relevant fora.

76. More particularly, the following files were mentioned:

    a) "EIB-ELM" (European Investment Bank - External Lending Mandate) (Proposal for a Decision of the European Parliament and of the Council amending Decision No 466/2014/EU granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union) (2016/0275 (COD));

    b) "EFSI" (European Fund for Strategic Investments) (Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 1316/2013 and (EU) 2015/1017 as regards the extension of the duration of the European Fund for Strategic Investments as well as the introduction of technical enhancements for that Fund and the European Investment Advisory Hub) (2016/0276 (COD));

    c) "Financial Regulation" (Proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union and amending Regulation (EC) No 2012/2002, Regulations (EU) No 1296/2013, (EU) 1301/2013, (EU) No 1303/2013, EU No 1304/2013, (EU) No 1305/2013, (EU) No 1306/2013, (EU) No 1307/2013, (EU) No 1308/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014,(EU) No 283/2014, (EU) No 652/2014 of the European Parliament and of the Council and Decision No 541/2014/EU of the European Parliament and of the Council (2016/0282 (COD));

d) ESI Funds: Legislative provisions on simplification (Amendments to Regulation (EU) No. 1303/2013, in the "Omnibus" (In the context of the new Regulation on financial rules applicable to the general budget of the Union) (discussed as part of the file 2016/0282 (COD));

e) Country by country reporting (CBCR) (Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (2016/0107(COD)).

77. A significant number of delegations, in the context of the mandate given by the Council to explore defensive measures in non-tax area, agreed that if these legislative files (without prejudice to the outcome of the ongoing negotiations) contain a link to the future list of non-cooperative jurisdictions, such provisions could constitute a set of effective and dissuasive defensive measures at EU level in non-tax area.

78. It was also noted that compromise texts on these future pieces of legislation require to be coherent and co-ordinated, to ensure consistency. All delegations and the Commission were invited to constructively contribute to that objective, as appropriate.

4. Further work

79. Following a balanced review of all information collected in the screening process, the Code of Conduct Group will report to the Council on those jurisdictions that do not comply with the screening criteria which, in the view of the Code of Conduct Group, the Council would decide, as appropriate, to include in the list of non-cooperative jurisdictions. It is noted that this decision will be taken by consensus.

80. This report will be presented, in co-ordination with the HLWP, to the Council in due time, so that the EU list of non-cooperative jurisdictions could be endorsed by the Council by the end of 2017 (as resolved in the Council Conclusions of 8 November 2016).

81. Once the Council endorses the EU list of non-cooperative jurisdictions, the Chair of the Code of Conduct Group will send letters to the listed jurisdictions without delay, with clear explanation of the reasons for such listing and which steps a jurisdiction concerned is expected to take, if it wishes to be de-listed.

82. In line with the above Council conclusions, the Code of Conduct Group and its relevant subgroup, in co-ordination with the HLWP, is expected, to "continue exploring defensive measures at EU level to be endorsed by the Council, in line with the Council Conclusions of May 2016".

VI. <u>Procedural issues</u>

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

83. 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*".

84. 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*".

85. 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.

86. 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. At the meeting of the Subgroup on 24 February 2017, the Commission services put forward a proposal for a revision of this guidance that was broadly welcomed by delegations. On this basis, the Maltese Presidency tabled a second draft compromise text at the subgroup meeting of 3 April 2017. The third draft compromise was agreed by the subgroup following a silence procedure and by the Code of Conduct Group on 8 June (see Annex 3).

87. The application of the principles of the modified nexus approach to non-IP regimes was discussed at the subgroup meetings of 24 February and 3 April 2017, but views of delegations were split between postponing 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 (probably not earlier than 2020) or postponing the development of guidance on a particular type of regime until that point in time when the FHTP review of preferential regimes falling under that type of regime has ended (e.g. presumably May 2017 for headquarters and financing/leasing regime) in order to capitalise on its empirical work.

88. 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 that further work will be required in this respect.

89. 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. Further work will be required on this matter.

2. Application of new guidance notes to past and ongoing assessments

90. The issue of whether new guidance agreed by the Group and endorsed by the Council should apply to past assessments (rollback procedure) or ongoing assessments emerged from discussions in the subgroup on the clarification of the third and fourth criterion but was then subsequently referred to the Code of Conduct Group given its horizontal nature.

91. The Code of Conduct Group meeting of 5 April 2017 confirmed that the 2008 guidance on procedural elements still applies. The issue of the application of new guidance to past and ongoing assessments will be further discussed.

Annex 1

Ministerie van Financiën

memo

Related/connected intellectual property (IP) under the Netherlands' innovation box

During the meeting of the Code of Conduct Group of April 5, 2017 the treatment of 'related/connected IP' as qualifying IP for the Netherlands' innovation box was discussed. The Netherlands' innovation box is fully consistent with Action 5 of the BEPS report and is unconditionally approved by the Forum on Harmful Tax Practices (FHTP) of the OECD. The types of IP assets that qualify for access to the innovation box were also explicitly reviewed by the FHTP.

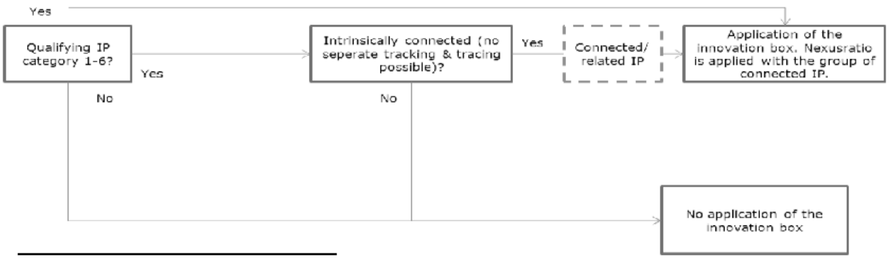
This memo explains that the treatment of 'related/connected IP' for the Netherlands' innovation (patent) box leads for all intents and purposes to the same material outcome as the IP boxes in other countries that follow the OECD approach regarding tracking-and-tracing.

The legislation in the Netherlands for the implementation of the nexus approach into Dutch tax law identifies seven categories of IP that qualify for the innovation box.[1] The seventh category was only included for reason of legal certainty, providing legal certainty to taxpayers as well as to the Tax Authorities about the qualification of related/connected IP for the Netherlands innovation box. The legislation does <u>not</u> create a new type of 'entry ticket'.

This seventh category fits in with the interpretation of the report on BEPS Action Item 5 by the FHTP. This interpretation considers whether separate tracking-and-tracing is possible of expenditures that are taken into account for the nexus fraction. If it <u>is not</u> possible to track-and-trace expenditures separately, this IP is defined as 'related/connected IP'. If separate tracking and tracing <u>is</u> possible, then no related/connected IP can be taken into account. Apart from this, trademarks and other marketing related IP never qualify for the Netherlands' innovation box.

In practice, the application of a seventh category and the tracking-and-tracing method as adopted by the FHTP have exactly the same result. As a consequence, the treatment of related/connected IP for the Netherlands' innovation box is in effect not different from the approach other Member States have taken.

Figure 1
The treatment of related/connected IP for the Netherlands' innovation box



[1] 1) A patent or plant breeders' right, 2) software, 3) a European permit to market a medicine, 4) a supplementary protection certificate of the Netherlands Patent Office, 5) a registered utility model to protect innovation, 6) an exclusive license to exploit IP stated in items 1° to 5°, 7) related/connected to an IP as referred to in points 1° to 6°.

Annex 2

Statement by the Italian Delegation on its IP Regime

The Italian delegation states that the recent legislative change (Decree-law n. 50 of 24 April 2017) amending the existing Italian IP regime was aimed at bringing the Italian IP regime in line with the Report on BEPS Action 5, including paragraph 35 of such Report (regarding eligible assets). In this respect, the Italian IP regime provides that, in order to benefit from such regime, all eligible IP assets should also meet both the following criteria: a) IP assets have to be legally protected and; b) taxpayers have to carry out research and development aimed at the production or development of the eligible assets. The upcoming Ministerial Decree will further clarify this. Given the above, the Italian IP regime will only grant tax benefits to eligible IP assets in accordance to what is provided for in paragraphs 34 to 38 in the Action 5 BEPS Report.

Annex 3

Guidance on tax privileges related to special economic zones

Without prejudice to the second paragraph of letter G of the Code of Conduct, the specific and detailed State Aid rules based on Article 107 TFEU and any other Guidance Notes that may be applicable to specific regimes, business tax privileges available for a special geographic area of a Member State ("special economic zones") will be the object of particular scrutiny by the Code of Conduct Group when one or more of the following circumstances are met:

a. access to the zone, either *de jure* or *de facto*, specifically favours foreign investors or discriminates against domestic investors or the tax benefits available to companies operating in the zone specifically favour transactions with non-residents or discriminate against domestic transactions;

b. the regulations for the zone place restrictions on activities that require a substantial economic presence;

c. the regulations do not require a definite *de jure* and *de facto* link between real economic activity carried on within the zone (such as distribution and manufacturing activities and activities that generate employment, assets and investments) and the profits for which the tax privilege is granted;

d. tax privileges are available also for the highly mobile activities (for example, activities typical of the banking or insurance industry, intra-group services or activities consisting only of the holding of equity participations and earning only dividends and capital gains) that are permitted in the zone;

e. there is a lack of regular tax audits verifying that the profits accruing in the zone and allocated to the activities to which tax privileges are available are commensurate with those activities;

f. the terms and conditions for establishing a zone, for being allowed to operate in the zone and for the benefits available for companies operating in a zone are not clearly defined in public legislation or are not limited in time, or permission to establish a zone or to be active in a zone is subject to discretionary powers.