



**COUNCIL OF
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LIMITE

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"I/A" ITEM NOTE

From : Enlargement Group (Tax Experts)
on : 3 October 2003
to : Permanent Representatives Committee/Council

Subject : Code of Conduct for Business Taxation
- Harmful tax measures in the acceding States and commitments for rollback

INTRODUCTION

1. The Council and the Representatives of the Governments of the Member States, meeting within the Council, adopted on 1 December 1997 a Resolution on a Code of Conduct for business taxation (OJ C 2, 6.1.1998).
2. The acceding States, in the context of the accession negotiations, committed themselves to comply with the principles of the Code of Conduct for business taxation and, notably, to introduce only new tax measures which are in conformity with these principles. Moreover, as indicated during the accession negotiations, the EU will closely monitor the implementation measures as regards full alignment with the principles of the Code, including possible measures to eliminate any tax provisions which may be contrary to these principles.

3. To this end, the Council must establish a list of tax measures in the acceding States which are harmful and which must be eliminated or amended in order to bring their corporate tax systems in line with the principles of the Code of Conduct by the date of accession.
4. With a view to establishing such a list, the Commission services prepared a report which was submitted to the Enlargement Group on 6 June 2003 (MD ELARG 82/03).
5. After a first examination of this report by the Enlargement Group, the majority of delegations expressed the view that, in view of the technical nature of the question, it was necessary to ensure that an appropriate expertise was brought to bear.
6. The Permanent Representatives Committee, at its meeting on 17 July 2003, subsequently asked the Enlargement Group to prepare the Council decision on a list of harmful measures in the acceding States. It was agreed that to this end the Enlargement Group could pursue its work in a suitable ad hoc formation composed of tax experts and by inviting delegations of acceding States to participate as necessary.

WORK OF THE GROUP

7. The mandate of the Group was to reach agreement and report back to the Permanent Representatives Committee on the following:
 - (i) a list of harmful tax measures
 - (ii) adequacy of rollback

8. The Group met on 5, 12, 19 and 26 September and on 3 October 2003 to finalise its work.
9. The Group carried out its work on the list of potentially harmful tax measures based on the proposed assessment by the Commission services contained in MD ELARG 82/03 and on documents submitted by the acceding and Member States. In taking its decisions, the Group followed the Code of Conduct criteria. The Group also noted the views of Member States on the application of the criteria as set out in the report to the ECOFIN Council in November 1999.
10. It should be noted that the present report reflects either the unanimous opinion of the members of the Group or the various reservations expressed in the course of discussion. References to 'the Group' in the report reflect the broad consensus and where unanimity was not achieved, alternative views are shown in the report as appropriate.

Final assessment

11. The Group's final assessment and the list of rollback commitments is contained in Annex to this report.
12. In total, the Group reviewed 52 potentially harmful tax measures on a country by country basis. It reached agreement on the evaluation of 21 tax measures as not harmful within the meaning of the Code of Conduct. Some Member States expressed reservations with regard to this assessment for the following measures: CY15 (Italy, Spain and the United Kingdom), CY16 (Italy and Spain), HU4 (Austria, Italy and Germany) and SL1 (Italy).

13. Furthermore, the Group reached agreement on the evaluation of 30 tax measures as harmful. In this regard, the United Kingdom expressed a general reservation with regard to measures ML4 and ML5 of Malta, since in its view the assessment goes beyond the scope of the Code of Conduct. The Group noted that some acceding States disagreed with the final assessment with regard to some of their measures: Lithuania (LT4) and Malta (ML4 and ML5).¹
14. Based on new information provided by Malta, the Group decided that the measure ML11 should be removed from the list of potentially harmful tax measures, as it appears to be a general feature of the Maltese tax system.

Adequacy of rollback

15. The Group also evaluated the rollback envisaged or already undertaken by the acceding States concerning their harmful tax measures.
16. With regard to 27 of the 30 harmful tax measures identified, the Group agreed on the adequacy of the rollback proposals to either remove the harmful features or to abolish the harmful tax measure. In the case of measures ML4 and ML5 for Malta, however, the Group took the view that the changes proposed by Malta were inadequate.² Malta disagreed with this view. Moreover, with regard to measure ML12 for Malta, several Member States (Belgium, France, Italy and Spain) expressed reservations concerning the adequacy of the rollback proposed.

¹ Malta stated that it did not accept the harmful qualification of ML4 and ML5 and expressed its position that the aspects considered harmful do not fall within the scope of the Code. Malta also stated its position that the changes proposed for ML4 and ML5 should therefore be considered adequate.

² The United Kingdom recalled its view that the assessment of these two measures goes beyond the scope of the Code of Conduct.

17. Finally, the Group took note of the intention of some acceding States to extend the benefits of certain harmful tax measures beyond 2005 (see in Annex).

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18. In light of the above, and subject to approval by Coreper, the Council is invited to take note of this report.

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Final assessment of the potentially harmful tax measures in the acceding States and commitments for rollback

Acceding State	Potentially harmful tax measures	Final assessment	Commitments for rollback
Czech Republic	1) Investment incentives	harmful	Issue of transparency will be addressed by removing the exclusion from a judicial appeal of a negative decision taken by the responsible Ministries, even when the conditions laid down in law are met. Timetable: amendment is at the moment under discussion in the Czech Parliament and should be in operation at the beginning of 2004.
Cyprus	1) International Business Companies / International Branches	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	2) Insurance Companies	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	3) International Financial Services Companies	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	4) International Banking Units	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	5) International general and limited partnerships	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	6) (International) Collective Investment Schemes	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	7) Shipping	not harmful	
	8) Capital gains	not harmful	

Cyprus	9) Foreign income	harmful	Repealed at the beginning of 2003.
	10) Export of services	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	11) Companies listed at the Cyprus Stock Exchange (CSE)	not harmful	
	12) Export of goods	harmful	Repealed at the beginning of 2003.
	13) Co-operative societies	not harmful	
	14) Auxiliary tourist buildings or projects	not harmful	
	15) Holding regime (treatment of foreign dividend)	not harmful	
	16) Foreign Branches	not harmful	
Estonia	None	not applicable	
Hungary	1) Offshore companies	harmful	Repealed at the beginning of 2003. Benefits expire on 31 December 2005 at the latest.
	2) 10 years tax holidays	not harmful	
	3) Venture capital companies	not harmful	
	4) Holding companies	not harmful	
	5) Investment tax relief subject to special approval	not harmful	

Latvia	1) Special Economic Zones and Free Ports	harmful	The issue of transparency will be addressed by changing the legislation: guidelines will be published on the procedure and evaluation of individual application. Procedures for evaluation of each indicator and the weight assigned thereto will be spelled out explicitly. Timetable: adoption of the relevant changes by 31 December 2003.
	2) High-tech companies	not harmful	
	3) Big investment schemes	not harmful	
	4) Shipping	not harmful	
Lithuania	1) Free Economic Zones	harmful	Amendments to legislation removing the additional benefits for non-residents and the possibility to carry out banking and insurance activities. Timetable: adoption of the relevant changes by 1 January 2004 or at the latest upon accession. Lithuania will request a transitional period for two companies until 31 December 2016.
	2) Benefits in respect of re-invested profits	not harmful	
	3) Enterprises with foreign invested capital	harmful	Repealed at the end of 2003.
	4) Strategic investors	harmful	Repealed. Lithuania will request a transitional period for existing beneficiaries until 31 December 2009.

Malta	1) Offshore trading and non-trading companies	harmful	Repealed in 1996. Transitional period ends on 23 September 2004.
	2) Offshore insurance companies / Insurance companies	harmful	Repealed in 1996. Transitional period ends on 23 September 2004.
	3) Offshore banking companies / Banking companies	harmful	Repealed in 1996. Transitional period ends on 23 September 2004.
	4) International Trading companies	harmful	<p>No distinction will be made between International Trading Companies (ITCs) and other companies resident in Malta with regard to the refund</p> <p>No distinction will be made with regard to the activities or income of a company in relation to the availability of the refund (i.e. the refund will be granted in relation to all profits made by the company)</p> <p>The refund will be extended in the same way to residents and non-residents alike.</p> <p>Timetable: the existing ITCs will continue to apply until 31 December 2012 to companies registered prior to accession. The proposed changes to Malta's tax system will be introduced by 31 December 2003.</p>

Malta	5) Dividends from (other) Maltese companies with foreign income	harmful	<p>The amendments will provide that, in respect of holdings acquired on or after 1 May 2004, the definition of a participating holding will include the following:</p> <ul style="list-style-type: none"> • the introduction of a minimum holding period requirement; • the requirement that shares must be held in a company; <ul style="list-style-type: none"> o which is resident in an EU or EEA jurisdiction; or o which is resident in a treaty jurisdiction; or o where the majority of the income is not derived from passive sources (i.e. interest, royalties and rents). In the case of passive income, the particular income must have suffered tax at an overall effective rate of at least 10%. <p>The amendments will also permit Maltese companies in receipt of dividends or gains to opt for an exemption from Maltese tax on such income or gains provided that the said dividends or gains are derived from holdings satisfying conditions essentially similar to those described above.</p> <p>With regard to shareholdings acquired before 1 May 2004, the current rules will apply until 31 December 2010.</p>
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Malta	6) Shipping	not harmful	
	7) Investment Service Companies	harmful	The entitlement to additional tax deductions currently granted to investment service companies will be removed. Timetable: upon accession at the latest. Malta will request a gradual phasing out of benefits of existing beneficiaries until 31 December 2010 at the latest.
	8) Business Promotion Act	not harmful	
	9) Onshore free port	not harmful	
	10) Business Promotion Regulations	not harmful	
	11) Non-resident companies	not applicable	

Malta	12) Special granted tax exemption	harmful	<p>Introduction of guidelines which limit the discretionary power of the Minister to grant tax exemptions only to philanthropic, charitable or other not-for-profit undertakings except:</p> <ul style="list-style-type: none"> - where the application relates to a specific project in Malta which is the subject of funding from the EU, EBRD, World Bank, USAID, DFID, or any other international funding agency; or - where the application relates to the construction of publicly funded projects in Malta which are regarded to be of national importance, not resulting in services supplied to other states, such as the construction of major roads, bridges, tunnels, power plants, public hospitals, waste treatment projects and other major infrastructural projects of national importance; or - where the application is made by a resident of a country which has no double taxation agreement with Malta and the business profits would not have been subject to tax in Malta had a double taxation agreement based on the OECD model been in place and subject to the condition that these profits will suffer tax in the other country at an overall effective rate of at least 10%.
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Malta			<p>Where, in the above-mentioned circumstances, the subsidiary company or permanent establishment in Malta receiving the exemption engages in transactions with related companies resident in other Member States, Malta will exchange information with these Member States and inform them of the special approval to exempt the company or permanent establishment in Malta as soon as possible. Malta will also inform the Member State of the special approval where the parent company or the company of the permanent establishment is a resident.</p> <p>Timetable: the guidelines will be introduced upon accession at the latest.</p>
Poland	1) Special Economic Zones (original rules)	harmful	<p>Mielec zone: the possibility of granting export aid was eliminated by the Act Amendment in November 2000.</p> <p>According to the Accession Treaty (Competition chapter), Poland may apply a transitional period to small enterprises up to and including 31 December 2011 and to medium-sized enterprises up to and including 31 December 2010.</p>
	2) Special Economic Zones (amended rules)	harmful	<p>Amendments to the rules so that the Minister will not have an authorisation to issue permits without a tender.</p> <p>Timetable: upon accession.</p>

Slovakia	1) 10-years tax holiday for foreign owned companies	harmful	Already repealed. According to the Accession Treaty (Competition chapter), Slovakia may apply a transitional period to one beneficiary until the end of the fiscal year 2008.
	2) Tax exemption for newly started companies	harmful	Already repealed.
	3) 100% corporate income tax credits for foreign investors	harmful	Already repealed.
	4) 100% corporate income tax credits for foreign investors (first amendment)	harmful	Removal of requirement of foreign participation. Timetable: amendments are now under discussion in the Slovak Parliament with the entry into force planned on 1 January 2004.
	5) 100% corporate income tax credits for foreign investors (second amendment)	harmful	Removal of requirement of foreign participation. Timetable: amendments are now under discussion in the Slovak Parliament with the entry into force planned on 1 January 2004.
Slovenia	1) Special Economic Zones	not harmful	
	2) Foreign income	harmful	Slovenia is drafting its tax reform and will introduce the following anti-abuse measures: the exemption would be granted to qualified shareholdings (at least 25% and 24 months duration) or in the case of profits of a permanent establishment, if the tax rate in the country of the subsidiary or the permanent establishment is at least 12.5%. Timetable: at the latest upon accession
	3) Newly established companies	not harmful	