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REPORT

From:	General Secretariat of the Council
To:	Delegations
Subject:	Code of Conduct Group (Business Taxation) - Report to the Council

I. BACKGROUND

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, which was established on 9 March 1998.[1] It also provides that the Code of Conduct Group (hereafter "COCG" or "Group") "*will report regularly on the measures assessed*" and that "*these reports will be forwarded to the Council for deliberation and, if the Council so decides, published*" (paragraph H).

In its conclusions of 8 December 2015,[2] the Council expressed the wish to improve the visibility of the work of the COCG and agreed "*that its results, in particular its 6-monthly reports, are systematically made available to the public*" (paragraph 16).

[1] ST 6619/98.

[2] ST 15148/15.

In its conclusions of 8 March 2016,[3] the Council furthermore called "*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).

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This report from the COCG encompasses the work of the Group in the second half of 2022 during the term of the Czech Presidency of the Council. The previous reports, guidelines and other documents can be found on the website of the Council of the EU (Code of Conduct Group)[4].

II. GENERAL ASPECTS

1. Organisation of work

In the first half of 2022, the COCG, under the chairmanship of Mrs. Lyudmila Petkova, Director of the Tax Policy Directorate, Ministry of Finance of the Republic of Bulgaria, has continued to fulfil its mandate in accordance with the agreed work programme.

Meetings of the COCG were held on 20 September, 24 October and 23 November 2022. The sub-group on internal/external issues met on 6 July, 9 and 15 September, 24 October, 15 November and 9 December 2022.

At the COCG meeting on 20 September 2022, Ms. Jana Alexander (Czechia) and Mr. Johan Lindqvist (Sweden) were confirmed respectively as the first and the second vice-chairs for the period up to the end of the Czech Presidency.

At the same meeting, the Group approved a work programme until the end of the Czech Presidency as set out in doc. 12720/22.

[3] ST 6900/16.

[4] https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group.

2. Revision of the Code of Conduct

In the Council conclusions of 18 June 2021[5], Finance Ministers welcomed the ongoing discussion on the reform of the scope of the mandate that should also cover features of tax systems that have general application and that may have harmful effects and invited the Group to pursue the work. The Code of Conduct Group and the Working Party on Tax Question (High Level) discussed the revision of the Code of Conduct (Business Taxation) during the German, Portugal and Slovenian Presidencies. On 7 December 2021, the Ecofin Council considered the draft revised Code of Conduct and welcomed the progress achieved by the Code of Conduct Group with regard to the reform of the Code of Conduct[6]. In its Conclusions on 17 June 2022 the Council recalled the discussion on the revision of the Code of Conduct and asked the Group to continue working with a view to advancing the reform[7].

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On this basis, the Czech Presidency continued the work on the reform of the Code of Conduct. Presidency compromise texts of the Resolution on a revised Code of Conduct for Business Taxation and the accompanying Council conclusions were considered at the Code of Conduct Group meeting on 24 October 2022.

On 8 November 2022 the Council approved the conclusions on the reform of the Code of Conduct for business taxation and the Resolution of the Council and the representatives of the governments of the Member States, meeting within the Council, on a revised Code of Conduct for business taxation.[8]

III. STANDSTILL AND ROLLBACK REVIEW PROCESSES

A call for standstill and rollback notifications of new preferential tax measures enacted by the end of 2021 was launched in mid-November 2021, the results were presented at the COCG meeting of 24 January 2022.

[5] ST 9896/21.
[6] ST 14814/21.
[7] ST 10346/22.
[8] ST 14452/22.

The following new regimes were identified[9]:

- Ireland: Digital games relief (IE017);
- Italy: Option for an increased deduction of R&D costs relating to certain IP assets (IT023);
- Italy: Amendments to the existing Notional Interest Deduction regime to apply the interest rate of 15% to increase of equity in 2021 (IT024);
- Poland: Holding tax regime (PL015);
- Poland: Robotisation tax relief (PL016);
- Romania: Exemption from payment of the tax specific to certain activities for the taxpayers in the field of HORECA (RO012);
- Slovakia: Tax measure aimed at supporting investments into certain fixed assets (SK009).

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1. Standstill review process

The following decisions were reached by the Group:

1. Croatia's newly introduced tax incentive for investment projects in the manufacturing industry (HR019, notification on 2020) – the COCG took note of the draft assessment of the measure and agreed to put the procedure on hold since Croatia has committed to amend its legislative framework within 18 months and to keep the COCG informed on the progress regarding the legislative framework.

2. Greece's patent tax incentive (IP regime) (EL015 REV) – the COCG agreed to treat the OECD description as an "agreed description" for the assessment of this measure and agreed that this measure is not harmful.[10]

3. Poland's holding tax regime (PL015) – the COCG agreed that the regime is overall not harmful.[11]

[9] See updated compilation in doc. 8602/4/20 REV 4.

[10] See ADD 1 and ADD 2.

[11] See ADD 3.

As regards Ireland’s digital games relief (IE017), the measure has been on hold until the state aid procedure was settled. On 27 September 2022, the measure was approved under State aid rules[12]. Hence, the Commission and Ireland are working jointly on an agreed description of the measure.

The standstill review of Romania’s profit tax exemption for companies with innovation and R&D activities (RO008) is kept on hold until the relevant national legislation is adopted: this regime is currently not applied because the subsequent administrative acts have so far not been adopted.

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IV. MONITORING OF THE ACTUAL EFFECTS OF INDIVIDUAL MEASURES

During recent years, some of the measures subject to scrutiny were put under annual monitoring.

This year, delegations were requested to submit the relevant data also for the year 2020. At its meetings of 20 September and 23 November 2022, the Group concluded as follows:

1. Greece's patent tax incentive (EL015) measure does not seem to have affected in a significant way the business location among the Member States and the monitoring of this measure can be terminated after the monitoring year 2021[13].

2. Lithuania’s SEZ and intra-group services (IP component) (LT005) measure does not seem to have affected in a significant way the business location among the Member States and the monitoring of this measure can be terminated in respect of the use of the potential IP component.[14]

[12] Commission Decision C(2022) 6904 of 27 September 2022 in case SA.102047.
[13] See ADD 4.
[14] See ADD 5.

3. Lithuania's Extension of CIT incentive for the SEZ (LT006) measure does not seem to have affected in a significant way the business location among the Member States and the monitoring of this measure should be terminated.[15]

4. Luxembourg's Intra-Group Financing - safe harbour rule (LU016) measure does not seem to have affected in a significant way the business location among the Member States but the Group should continue looking into the effects in the next year's monitoring exercise.[16]

5. Poland's Notional interest deduction regime (PL011) measure does not seem to have affected in a significant way the business location among the Member States but the monitoring of this measure should continue.[17]

6. Portugal's Notional interest deduction regime (PT018) measure does not seem to have affected in a significant way the business location among the Member States but the monitoring of this measure should continue.[18]

The Group took note of the ongoing work between the Commission services and the Cypriot and Polish authorities to prepare the analysis concerning the use of safe harbour rules (monitoring of compliance with 2013 Guidance on intermediate companies).

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[15] See ADD 6.
[16] See ADD 7.
[17] See ADD 8.
[18] See ADD 9.

V. COCG GUIDANCE NOTES

2. On 29 October 2020 the Group agreed on the questionnaire for monitoring the implementation of the 2017 Guidance on tax privileges related to special economic zones presented at the COCG subgroup on internal issues meeting on 23 October 2020. Responses from the Member States were requested by 31 March 2021[19]. In its meeting of 19 May 2021, the Group decided to follow up on selected horizontal issues and requested further clarifications from the Member States concerned. Subsequently, in-depth technical analysis and work was pursued.

3. At the COCG meeting of 23 November 2022, the Group took note of the interim findings by the Commission regarding Member States' compliance with the guidance and agreed on the basic approach taken in this monitoring exercise consisting of (i) a risk-based approach for the data collection regarding the *de facto* use and (ii) monitoring for highly mobile activities. The Commission services tabled a draft assessment of EU Member States' compliance with this guidance and the Group concluded that all Member States are compliant, but the measures in five Member States shall be "under particular scrutiny" with regard to highly mobile activities carried out in the SEZ.[20] The Group agreed that a new monitoring of all the SEZ regimes in force at that point in time should take place in the future (e.g. 2027).

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[19] WK 5161/2021 + ADD 1-10.

[20] See ADD 10.

VI. THE EU LIST OF NON-COOPERATIVE JURISDICTIONS FOR TAX PURPOSES

1. Update of the EU list of non-cooperative jurisdictions for tax purposes

In its conclusions of 17 June 2022[21], the Ecofin Council welcomed the positive effect of the Code of Conduct and the work of the Group on reducing harmful tax practices and the decrease of preferential tax regimes both at the EU level and globally and invited the Code of Conduct Group to continue an effective dialogue with jurisdictions and monitoring, so that jurisdictions continue to fulfil their respective commitments and comply with the EU listing criteria in accordance with the agreed deadlines. The Council also welcomed the recent dialogue with jurisdictions engaged in reforming their foreign source income exemption regimes (FSIE), with no or only nominal tax jurisdictions in the context of monitoring the implementation of economic substance requirements under criterion 2.2, and with relevant jurisdictions regarding the implementation of the country-by-country reporting (CbCR) anti-BEPS minimum standard (criterion 3.2).

The COCG continued interactions and dialogue with the relevant jurisdictions to assess recent developments and the implementation of their commitments, with a view to the update of the EU list.

The Group mandated the Subgroup on external issues to discuss urgent issues related to the update of the EU list at the meetings on 6 July, 9 and 15 September 2022 in the run-up to its meeting on 20 September 2022. The updated EU list of non-cooperative jurisdictions was approved by the Council on 4 October 2022[22] and published in the Official Journal on 12 October 2022.[23]

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[21] 10346/22.
[22] 13092/22.
[23] OJ C 391, 12.10.2022, pages 2-5.

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There are 12 jurisdictions on the EU list after the update. Three jurisdictions were added to the EU list: Anguilla, The Bahamas and Turks and Caicos Islands. The reason for their inclusion in the list is that there are concerns that these three jurisdictions, which all have a zero or only nominal rate of corporate income tax, are attracting profits without real economic activity (criterion 2.2 of the EU list). In particular, they failed to adequately address a number of recommendations of the OECD Forum on Harmful Tax Practices (FHTP) in connection with the enforcement of economic substance requirements in practice. The entry on Anguilla also reflects its ongoing supplementary review by the Global Forum in relation to Exchange of Information on Request (criterion 1.2). The entry of The Bahamas reflects also its commitment to address the BEPS Inclusive Framework’s (BEPS IF) recommendations with regard to the implementation of criterion 3.2 on Country-by-Country Reporting (CbCR) in due time. Nine jurisdictions remained listed in Annex I: American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, US Virgin Islands and Vanuatu.

Annex II features two new commitments in the context of the work of the FHTP on harmful preferential tax regimes: both Armenia and Eswatini committed to abolish or amend their preferential tax regimes by 31 December 2023 (criterion 2.1).

The commitments taken by Barbados to address the FHTP recommendations with regard to the enforcement of economic substance requirements under criterion 2.2 were considered in the context of the update of the EU list in October and allowed the COCG to decide to wait until the FHTP concludes on this issue at its meeting in November 2022.

Turkey remains included in Annex II for criterion 1.1 (automatic exchange of information) as it is still not fully in line with the commitments required under the conclusions of the Ecofin Council of 22 February 2021, 5 October 2021, 24 February and 4 October 2022. Turkey is expected to begin or continue the technical work on the effective exchange of data from Turkey with all Member States to meet the agreed international standards and fully comply with the requirements set in the mentioned conclusions of the Ecofin Council.

2. Monitoring of the implementation of commitments taken by jurisdictions

General overview

As of October 2022, the implementation of a total of 25 commitments[24] taken at a high political level by 22 jurisdictions[25] remains to be monitored by the Group. These are recorded in Annex II of the Council conclusions:

Criterion	Number of jurisdictions committed
1.1	1
1.2	5
2.1	11
2.2	2
3.2	7

Specifically, a total of 11 harmful tax regimes remain to be rolled back under criterion 2.1, 6 of which are under monitoring by the COCG[26] and 5 by the OECD FHTP[27]. A detailed overview may be found in the compilation[28] of preferential regimes and measures examined by the COCG under criteria 2.1 and 2.2.

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[24] This figure adds up the number of commitments by jurisdictions under each criterion (see table).

[25] Armenia, Barbados, Botswana, Belize, British Virgin Islands, Costa Rica, Dominica, Eswatini, Hong Kong, Israel Jamaica, Jordan, Malaysia, Montserrat, North Macedonia, the Russian Federation, Seychelles, Thailand, Turkey, Uruguay and Vietnam.

[26] The FSIE regimes of Costa Rica, Hong Kong, Malaysia, Qatar, Uruguay and the Russian Federation's „International Holding Companies" regime.

[27] Jamaica's "Special economic zones" regime; Jordan's "Aqaba special economic zone" regime and North Macedonia's "Technological industrial development zone" regime, Eswatini's "Special economic zone", Armenia's "Free economic zones" and "Information technology projects"

[28] ST 14343/21.

Procedural and political aspects of the monitoring process

The Chair of the COCG continued to conduct political and procedural dialogues with relevant international organisations and jurisdictions, where necessary.

The Chair received a number of letters from jurisdictions and also held in-person meetings and video-conferences at a high political level with a number of them. Delegations were kept informed about these interactions, and response letters signed by the Chair were agreed by the Group.

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3. Screening and scoping issues

Criterion 1.1 (peer reviews by the Global Forum with respect to the Common Reporting Standard for AEOI)

From the outset, criterion 1.1 has been designed to evolve in line with the peer review process on the Automatic Exchange of Financial Account Information (AEOI) by the Global Forum on tax transparency and exchange of information (Global Forum). The 2016 Council Conclusions on the criteria and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes[29] envisaged that once the Global Forum started assessing the effective implementation of AEOI, criterion 1.1 should reflect the outcomes of the Global Forum peer review process on AEOI.

[29] Council conclusions (8 November 2016) on the criteria and process leading to the establishment of the EU list of non-cooperative jurisdictions for tax purposes, document: 14166/16.

Since 2020, the Global Forum has been reviewing annually the domestic and international legal frameworks put in place by member jurisdictions to implement the international standard on AEOI, in particular by issuing determinations on their legal framework for the relevant core requirements 1 and 2 under the Terms of Reference for the peer reviews of the AEOI standard[30]. In 2022, as part of the peer review process on AEOI, the Global Forum issued for the first time *ratings* on the effectiveness of the implementation of the AEOI standard in practice.

In June 2022, the Code of Conduct Group agreed on a two-step approach to implement criterion 1.1, taking stock of the evolution of the Global Forum peer reviews on AEOI, starting with the 2022 report. The Group also adopted Guidance on the implementation of the updated criterion 1.1 under the first step[31]. In particular, the Guidance clarified that the benchmark for COCG assessments for criterion 1.1 are the legal determinations attributed to jurisdictions by the Global Forum for implementing the required domestic and international legal framework. The minimum level of compliance required for jurisdictions in scope is "In place, but needs improvement" for both Core Requirement 1 and Core Requirement 2 in the AEOI Terms of Reference. Letters signed by the Chair were sent to all concerned jurisdictions to inform them about this update. At the meeting on 24 October 2022, the COCG agreed on the way forward regarding the jurisdictions that the Global Forum found to be non-compliant based on the AEOI peer reviews for 2022.

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[30] The Terms of Reference for the peer reviews of the AEOI standard require domestic legal frameworks in place to implement the AEOI standard to oblige Financial Institutions to conduct the due diligence and reporting procedures (Core Requirement 1), as well as international legal frameworks to exchange the information, including exchange relationships in effect for each jurisdiction with all Interested Appropriate Partners (Core Requirement 2).

[31] Annex to 10346/22.

The 2022 Global Forum peer review report on AEOI was published on 9 November 2022[32]. Letters signed by the Chair requesting commitments to address the deficiencies were subsequently sent to jurisdictions, which did not demonstrate a sufficient level of compliance in the 2022 AEOI peer review. [33] Concerned jurisdictions were asked to make commitments in view of the update of the EU list in early 2023.

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Foreign source income exemption regimes

In October 2019, the Ecofin Council approved guidance on foreign source income exemption (FSIE) regimes in the framework of the EU listing exercise (criterion 2.1). This guidance acknowledges that FSIE regimes are a legitimate approach to prevent double taxation, but identifies potentially harmful elements that could be present in such regimes.

In December 2019, the COCG Chair wrote to thirteen jurisdictions to inform them that a regime of this kind was identified in their jurisdiction. The Commission services followed up with a questionnaire to nine jurisdictions in February 2020 with a deadline of 20 March 2020 to reply. It was agreed to screen four jurisdictions at a later stage.

All the jurisdictions that have been contacted responded to the questionnaire. The Commission services analysed the replies and followed up where necessary. On this basis, the Commission services prepared an overview of the work carried out so far, as well as country-specific progress reports.

On 19 May 2021, the COCG agreed to send letters to six jurisdictions from which the COCG would seek commitments to repeal or amend their harmful FSIE regimes. Five jurisdictions responded and confirmed their commitment to abolish or amend their regimes[34]. One jurisdiction did not express the requested commitment[35]. The remaining three jurisdictions[36] were deemed compliant under the EU listing criteria.

[32] https://www.oecd-ilibrary.org/taxation/peer-review-of-the-automatic-exchange-of-financial-account-information-2022_36e7cded-en.
[33] Aruba, Belize, Curaçao, Costa Rica, Israel and Trinidad and Tobago.
[34] Costa Rica, Hong Kong, Malaysia, Qatar and Uruguay.
[35] Panama.
[36] Maldives, Nauru and Singapore.

In the course of the second half of 2021 and 2022, the COCG continued its work on the assessment of the ongoing FSIE reforms by the concerned jurisdictions.

During the technical examinations of FSIE reforms (i.e. tax treatment of capital gains), there was a need to clarify the language of the Guidance on FSIE on certain aspects. On 23 November 2022, the COCG agreed amendments to the Guidance on FSIE regimes to reflect the current practice of the COCG. The updated guidance is set out in the Annex to this report.

As a result, the COCG agreed that some jurisdictions with ongoing FSIE reforms are asked to complete their reforms by the end of 2022, with the effect on 1 January 2023 and their reforms on the treatment of capital gains by the end of 2023, with effect from 1 January 2024. Some other jurisdictions should be informed that, if the additional screening of their FSIE regime results in non-compliance with the revised FSIE guidance, they will be asked to make a commitment to amend the regime by 30 June 2024, with effect from 1 July 2024.

Monitoring under criterion 2.2

In July 2021, the Group decided to carry out the annual monitoring of the enforcement of economic substance requirements by 2.2 jurisdictions[37] by ensuring synergy with the parallel monitoring by the FHTP of no or only nominal tax jurisdictions.

[37] These jurisdictions include the twelve no or only nominal tax jurisdictions (Anguilla, Bahamas, Barbados, Bahrain, Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, Turks and Caicos Islands, United Arab Emirates) and the Republic of Marshall Islands.

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At its meeting on 2 June 2022, the Group decided to take into account the conclusions reached by the FHTP at the April meeting on the 2021 monitoring (which relates to the enforcement of the substance requirements for the years 2019 and 2020) and any progress made by the jurisdictions concerned in the monitoring areas up until the update of the EU list in October 2022. This ad-hoc approach was taken exceptionally due to the specific timing-related circumstances of this first year of monitoring. The Group also decided that, from 2023 onwards, it would take into account the FHTP conclusions reached in the last quarter of the year before, in preparation of the update of the EU list in the first quarter of the year that would follow such conclusions.

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In addition, the Group discussed the situation of entities or arrangements which can carry out highly mobile activities in the scope of criterion 2.2 and which have not yet been included in the scope of domestic legislation on economic substance requirements in all 2.2 jurisdictions. The Group agreed to start a screening exercise for trusts and fiduciaries similar to that of 2019 on partnerships, given that criterion 2.2 has a comprehensive scope, encompassing in principle all entities or arrangements. To this aim, the Group also decided to bring this work forward in close cooperation with the Forum on Harmful Tax Practices, which agreed to conduct a parallel mapping exercise at its meeting in November 2022.

At the 2 June meeting, the Group also agreed to take into account the recently adopted FHTP guidance on pure equity holding companies and entities claiming tax residence in another no or only nominal tax jurisdiction under criterion 2.2.

Process for the Monitoring of Economic Substance Requirements for Collective Investment Funds (CIVs) under criterion 2.2

In May 2018, the COCG agreed on Technical Guidance on Substance Requirements for Collective Investment Funds (CIVs) giving effect to a distinctive treatment for CIVs, in terms of economic substance requirements, in the Scoping Paper on criterion 2.2.

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In September 2018, the COCG found that four jurisdictions (Bahamas, Bermuda, British Virgin Islands (BVI) and Cayman Islands) in the scope of the EU listing process had a "relevant" fund sector. Subsequently, the COCG asked these jurisdictions to reform their funds' framework in line with the Technical Guidance[38]. The reforms, approved by the COCG, entered into effect in these jurisdictions in 2020, i.e. one year later than other economic substance requirements (general substance requirements).

At its meeting on 27 April 2022, the COCG agreed on a monitoring process for the implementation of substance requirements specific to CIVs. The Group discussed the main findings of this monitoring and agreed to send recommendations to the jurisdictions with regard to the identified deficiencies at its meeting on 23 November 2022.

The Commission will update the Group, on a regular basis, on the need to extend the monitoring exercise to other relevant 2.2 jurisdictions, if any, in the future.

Implementation of criterion 3.2

In 2019, the COCG agreed on a general approach for assessing compliance with criterion 3.2 on country-by-country reporting (CbCR), in particular for early adopters of the minimum standard on CbCR, i.e. jurisdictions that joined the Inclusive Framework before the end of 2017.

In October and November 2021, the Code of Conduct Group discussed and agreed on the assessment of the relevant jurisdictions for compliance with criterion 3.2, based on the 2021 Peer Review Report by the BEPS Inclusive Framework (IF) on CbCR. Eleven jurisdictions with identified deficiencies on CbCR were asked to undertake commitments to address these deficiencies by next year, in time to be reflected in the 2023 IF peer review report on CbCR. These commitments were recorded at the update of the EU list in February 2022.

[38] Bahamas, Bermuda, British Virgin Islands (BVI) and Cayman Islands.

Following the release of the latest IF peer review report on CbCR on 4 October 2022, the Code of Conduct Group decided at its meeting on 24 October 2022 to remove Barbados and British Virgin Islands from Annex II for criterion 3.2 and to remove the reference to criterion 3.2 in the entry of the Bahamas in Annex I, at the next update of the EU list.

At the meeting on 23 November 2022, the Code of Conduct Group considered the implementation of the CbCR standard by other jurisdictions within the scope of criterion 3.2, which were not deemed deficient in 2021, as well as the state of play in relation to relevant jurisdictions to which criterion 3.2 has not been applied so far, as they have joined the BEPS IF after 1 January 2018. The COCG agreed to extend the scope of criterion 3.2 to those jurisdictions, which joined the Inclusive Framework on BEPS after 1 January 2018 and are developed countries or developing countries without a financial centre. The jurisdictions concerned will be informed about the application of criterion 3.2 in a timely fashion.

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Defensive measures vis-à-vis third country jurisdictions

In line with the Guidance on defensive measures agreed in December 2019, the COCG resumed its work on defensive measures. On 1 February 2021, the COCG agreed that Member States should update the COCG on the state of play as regards defensive measures that they apply towards non-cooperative jurisdictions for tax purposes.

An overview of the currently applied measures was attached to the COCG report to the Council[39].

The Subgroup continued the discussion at its 16 and 31 March and 18 May meetings on effective application of the defensive measures, in accordance with the agreed Guidance. At the meeting of 2 June 2022, the Group agreed to continue working on this matter based on a staged approach. As a first step, an analysis could be conducted on how defensive measures have been effectively applied by Member States. The outcome of such analysis could serve as a basis for further discussions on whether and how coordination of the measures could be enhanced.

[39] ST 14230/21.

At the meeting on 20 September, the Code of Conduct Group agreed the draft questionnaire on the application by Member States of defensive measures. Member States were invited to reply by 30 November 2022.

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Review of the economic data used for selecting jurisdictions

In March 2019 the Ecofin Council recalled "*the extensions of the geographical scope of the EU screening exercise to other jurisdictions agreed in 2018*"[40] and invited "*the Code of Conduct Group to review the economic data used for selecting jurisdictions in 2020, for application as from 2021*". This invitation was reiterated in February 2020 with a view "to focus on the most relevant jurisdictions, having regard to the agreed work on the extended geographical scope as identified in 2018".

At the meeting of 20 April 2021, the Fiscal Attachés had an exchange on a possible revision of the geographical scope of the EU list, taking into account the prioritization table prepared by the Commission services and a note by the Chair and the Presidency. Further work will be necessary on this issue, in order to decide the approach to be used for selecting jurisdictions for the geographical scope of the EU screening exercise.

[40] ST 14364/21.

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Guidance on foreign source income exemption regimes[41]

On 20 May 2019, the Code of Conduct Group (COCG) agreed on an approach to assess foreign source income exemption regimes. Based on this approach, these guidelines should provide direction for jurisdictions that have already taken a commitment to amend their foreign source income exemption regimes, due to harmful features identified by the COCG. The guidelines will also serve as a basis for the screening of other jurisdictions with similar regimes. Foreign source income exemption regimes, or regimes that charge corporate tax on a territorial basis are not, in themselves, problematic. In fact, exempting foreign profits is acceptable and even recommendable, in certain cases, to prevent double taxation. However, problems arise when such regimes not only prevent double taxation, but also create situations of double-non taxation. This is particularly the case for regimes that have (i) an overly broad definition of the income excluded from taxation, notably foreign source passive income without any conditions or safeguards, and/or (ii) a nexus definition that is non-compliant with the definition of a permanent establishment in the OECD Model Tax Convention.

The COCG has assessed such regimes in the past and has drawn on COCG precedents as the basis of this Guidance. Past assessments will not be affected by this guidance to the extent that such assessments took account, where relevant, of the clarifications of this text (see footnote 1) and came to a conclusive analysis of all types of income which are mentioned in this guidance. Regimes that have not been reviewed by the COCG can be reviewed on the basis of this guidance and the criteria of the Code of Conduct. The current procedure for reopening past assessments remains valid.

[41] The text was clarified in 2022 to ensure transparency and consistency in the evaluation of jurisdictions.

Passive Income

In 2017, the COCG found that a tax system that fully excludes passive income with a foreign link from taxation, without any conditions, is harmful. This is the case even if the profits are determined using internationally established principles, as the end effect is the same as a regime providing beneficial treatment. In 2019, the COCG started screening several jurisdictions which have this kind of system in place.

Foreign source income exemption regimes that are broad enough to exclude from taxation passive income (including dividends, interest, royalties, and capital gains) without any conditions, can result in ring-fencing and a lack of substance. Ring-fencing arises because the receipt of passive income generally requires a transaction with a non-resident. Passive income is generally not coupled with economic substance requirements. The COCG has found that the exemption of passive income without clear conditions (e.g. explicit link to some real activity in the jurisdiction) contravenes the principles of the Code.

Active Income

The COCG agreed that the assessment of foreign source income exemption regimes should focus primarily on the exemption of passive income. However, it also agreed that it was essential to consider specific features of these regimes linked to active income – in particular, whether and how active income is taxed. In particular, regimes that extend the exemption to active income from foreign operations should also be carefully considered, as this can trigger cases of double non-taxation.

The analysis will therefore focus on the definition of the income deemed to have its source in the jurisdiction, as this will determine whether or not the business income is taxed according to international principles. This analysis will look at whether the jurisdiction applied a definition of permanent establishment in line with that of the OECD Model Tax Convention. This is the internationally agreed principle to assess the economic presence of an entity in another jurisdiction, to determine the allocation of the right to tax.

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Options for remedying harmful foreign income exemption regimes

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Regardless of the tax treatment of passive or active income arising from domestic sources, jurisdictions with foreign source income exemption regimes that are considered harmful should either abolish the regimes in question or amend them to remove the harmful features.

In relation to foreign source income, jurisdictions should either:

- introduce taxation of passive income; or
- if they exclude from taxation certain types of passive income:
  - implement adequate substance requirements to the entities concerned for all types of passive income concerned, in line with the EU's Code of Conduct (Business Taxation)[42];
  - have robust anti-abuse rules in place; and
  - remove any administrative discretion in determining the income to be excluded from taxation.

Furthermore, jurisdictions should ensure the application of internationally accepted principles in relation to the taxation of foreign source active income, notably with regard to the definition of permanent establishment provided by the OECD Model Convention on Double Tax Treaties (including by amending the definition of permanent establishment in a DTA in place already that does not respect international principles) and the consequent income allocation. To prevent double non-taxation, jurisdictions should ensure that the exemption of foreign source active income is granted only when the jurisdiction in which the income arises has subjected the income to tax in accordance with internationally accepted principles.

As each of these regimes has its own specificities, the COCG agreed that the Commission services should work with the jurisdictions in question to clarify the areas of concern. Solutions should be developed based on the guidelines above, to address the specific issues identified by the COCG for each regime. Accordingly, this Guidance should not be treated as a stand-alone document and should be accompanied by technical advice and interaction with the jurisdictions under review.

[42] Where jurisdictions are being assessed under Criterion 2.1, the substance requirements in the COCG guidance on the interpretation of the third criterion (doc. 10419/18) should apply. In this respect, it is noted that for royalties from intellectual property rights, the guidance on the modified nexus approach for IP regimes (doc. 16553/1/14 REV 1) should apply. Where jurisdictions are being assessed under Criterion 2.2, the substance requirements in the COCG scoping paper on criterion 2.2 (doc. 10421/18) should apply.

Review

The countering of harmful tax measures is an ongoing process. This guidance note will therefore be periodically reviewed by the COCG to ensure that it reflects future developments.

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