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**REPORT**

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| from : | Code of Conduct Group (Business Taxation) |
| to : | ECOFIN Council |
| on : | 4 December 2007 |
| Subject : | Code of Conduct (Business Taxation)<br>Report to the ECOFIN Council |

## 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, which provides for the establishment of a Group within the framework of the Council to assess tax measures that may fall within the Code. In its report to the Feira European Council on 19 and 20 June 2000, the ECOFIN Council agreed that work should be pursued with a view to reaching agreement on the tax package as a whole, according to a parallel timetable for the key parts of the tax package (Taxation of savings, Code of Conduct (Business Taxation) and Interest and Royalties).

2. On 9 March 1998, the Council confirmed the establishment of the Code of Conduct Group. The Group reported regularly on the measures assessed and these reports have been forwarded to the Council for deliberation.

3. Two interim reports of the Code of Conduct Group were presented to the ECOFIN Council on 1 December 1998 and 25 May 1999 respectively (12530/98 FISC 164 and 8231/99 FISC 119). Subsequently, the Group reported to ECOFIN on 25 November 1999 setting out the results of the Group's work (SN 4901/99) on the assessment of 271 tax measures under the Code where the Group considered 66 measures harmful.

4. On 13 October 2003, the Council welcomed a report by the Working Party on Enlargement (Tax Experts) (13213/03 ELARG 94 FISC 138) establishing a list of 30 measures found harmful under the Code in the states, which acceded on 1 May 2004. The Council also agreed on the adequacy of the rollback measures envisaged or already undertaken for 27 of these measures.

5. On 11 July 2006, the Council took note of a report by the Working Party on Enlargement (10879/06 ELARG 66 FISC 96) establishing a list of 8 measures found harmful under the Code in the two states (Bulgaria and Romania), which acceded on 1 January 2007.

6. This report from the Code Group encompasses the work of the Code Group in 2007 under the Portuguese Presidency.

7. As required by the ECOFIN Conclusions of 9 March 1998, the Group's reports reflect either the unanimous opinion of the members of the Group or the various opinions expressed in the course of discussion.

**PROGRESS OF WORK**

8. The Code of Conduct Group met on 19 September 2007, 16 October 2007 and 20 November 2007 under the Portuguese Presidency.

**Appointment of Chair**

9. On 14 September 2007, Mrs Dawn Primarolo, previously Paymaster General in the UK Treasury, and now Minister of State at the UK Department of Health, tendered her resignation as Chair of the Code of Conduct Group. In accordance with the Council conclusions of 9 March 1998, which govern the Group's procedures, a process was initiated to select a new Chair. As a result, at the meeting on 16 October, Mrs Jane Kennedy, the financial Secretary to the Treasury, was appointed by common accord as Chair of the Code of Conduct Group for a period of two years from 16 October 2007.

**Appointment of Vice-Chairs**

10. At the meeting on 19 September, Mr José Gomes Santos, Tax Counsellor of the Centre for Fiscal Studies in the Directorate for Taxation at the Portuguese Ministry of Finance, and Mrs Irena Erjavec, Director General of the Directorate of the System of Tax, Customs and Other Public Finance Revenues in the Ministry of Finance in Slovenia, were confirmed as the first and second Vice-Chairs respectively for the period up to the end of the Portuguese Presidency. The Group also confirmed a programme of work under the Portuguese Presidency, agreeing to take forward work in the following areas:

(a) Standstill;

(b) Subject to the Group's agreement, further discussion on the future of the Code of Conduct, based on the reflections of the Member States following the discussion of this issue at the ECOFIN Council on 5 June 2007.

**Standstill**

11. Member States are committed not to introduce new tax measures, which are harmful within the meaning of the Code. The Work programme for the Portuguese presidency identified the following three measures where further discussion under standstill was required:

- *Netherlands - Interest Box;*
- *Netherlands - Patent Box;*
- *UK: Isle of Man - The Distributable Profits Charge (DPC).*

12. The Group had previously requested the Commission Services to prepare descriptions of these in consultation with the Member States concerned.

13. The Group discussed the description of the Netherlands Interest Box. The Group agreed that the measure should be assessed against the Code Criteria when the current State Aids proceedings were complete.

14. The Group discussed the description of the Netherlands Patent Box. The Group agreed that there was no need for this measure to be assessed against the Code criteria.

15. In the case of UK: Isle of Man, the Group discussed the description of the Isle of Man – Distributable Profits Charge measure. It was agreed that the measure should be assessed against the Code Criteria. With the benefit of a draft assessment provided by the Commission Services, the Group agreed that the DPC should be given a positive evaluation under the Code. The United Kingdom accepted the view of the Group and agreed to keep the Group informed of progress in abolishing the measure.

**Future of the Code**

16. The Group reflected on the discussion which had taken place at the ECOFIN Council meeting on 5 June 2007 concerning the proposed "Future Work Package". In this respect it:

- agreed the procedural aspects of its future work (as contained in Annex I), with the exception of the Italian and Spanish delegations, which could not agree on the full first bullet point of the introductory paragraph concerning "General guiding principles concerning evaluation of measures";

- agreed a final version of the "Future Work Package", as contained in Annex II, but the Group noted a waiting reservation from the Dutch delegation.

## FUTURE WORK PACKAGE: PROCEDURAL ASPECTS

**Subject: Point 1 of the WP: Procedure and the role of precedence and comparability**
**Point 2 of the WP: Links with State aid proceedings**

**General guiding principles concerning evaluation of measures**

- In order to build on the framework of the Code of Conduct and increase transparency all new evaluations of the Code Group will have to be sufficiently substantiated taking into consideration all Code criteria, stating arguments and providing data where possible. The economic impact data should, if possible, include: tax data (e.g. taxable base, tax revenue foregone), number of companies benefiting, division between domestic companies and foreign owned companies. Without prejudice to the criteria in the Code, the Group could consider interpreting the economic impact data in relation to differences in size of country or market and openness of the economy of that MS, in assessing criterion 1, where the taking into account of objective economic factors would allow to avoid discrimination among Member States. This elaborated evaluation can then be used for future reference in case a MS claims precedence.
- Furthermore, the development or revision of guidance notes (e.g. on holding company regimes, R&D / royalty tax incentives and other regimes leading to a lower level of taxation) could help build on the results of the Group.
- Finally, the Group could consider that, in case a measure has been approved by the Group, the approval of this measure should not preclude a possible future reassessment of this measure in exceptional circumstances (after a reasonable timeframe and after MSs indications that their tax bases are significantly affected by this measure). Such reassessment will start only at the invitation of ECOFIN on the basis of an analysis of the facts made by the Group.
- The Group should accept that the Code assessments are not an exact science. In case of conflict of opinions, a more political discussion on precedence (or any other matter) cannot always be avoided.

## 1. Role of precedence and comparability

### 1.1. Guiding principles concerning 'Precedence'

- While each measure should be assessed on its merits under the peer review process, precedence has in the past and should in the future play a role in the Code of Conduct procedure. The claim for precedence as well as its assessment should be made in a transparent manner.
- The Group could consider to take the following approach if a Member State (MS1) claims precedence on the basis of a regime of another Member State (MS2):

  i) MS1 is required to provide a written document substantiating the claim for precedence, based on factors such as scope, design and general tax environment and (actual or estimate) data on the impact of the regime.

  ii) the Group will compare the regimes of MS1 and MS2. In this respect a comparability table (as suggested in Annex 1) can be used as tool to structure and focus the discussion.

  iii) in case the regime of MS2 was approved by the Group in the past with question marks on criteria 1b and 2b, MS2 can be requested to provide new information on economic impact in case these data are relevant for comparing them with MS1 economic data. MS 2 regime will not be automatically re-evaluated.

### 1.2. Guiding principles concerning 'Comparability':

- A comparison of tax measures should be based on the characteristics of the measure which are relevant from a Code of Conduct perspective.
- In order to enable the Group to make a relevant comparison between tax measures a table (as suggested in Annex 1) can be used as a tool to specify the comparables in cases of claims for precedence. As preliminary remarks the Group could consider that:

  - the elements in the table should not be used as a cumulative requirement list since requiring 100% comparability would undermine and erode the principle of precedence and equal treatment;

  - the left column of the comparability table contains a full list of the elements derived from the Code of Conduct that are relevant in the comparison. The list of comparables, in the right column of the table, sets out factors which may be considered relevant for the Code of Conduct but is in principle non-exhaustive;

- 'type of income' is a relevant comparable since the Code focuses on measures that affect the location of business activities. The Group could consider that if a measure targets a type of income which is relatively mobile, one could argue that the measure is more likely to affect the location of business activities than a measure that targets a less mobile type of income (determined on the basis of the actions needed and risks run by relocating the underlying asset or activity that generates the income or the possibilities to re-route a flow of income from the companies actually paying the income). On the basis of the measures the Group reviewed in the past, the Group could try and develop a table to be used as a more detailed comparability tool.

**2. Procedure**

- The procedures in question relate to the way conclusions are reached in the Code of Conduct Group. In this context, the Group should maintain to aim at a (broad) consensus to reflect the MSs positions in the Code of Conduct Group in future reports to ECOFIN, to avoid loosing the effectiveness of the Code Group, while respecting the principle of unanimity as laid down in paragraph 14 of the Council conclusions concerning the establishment of the Code of Conduct Group (9 March 1998, 98/C99/01).
- Therefore, the Group could consider that the Code of Conduct reports to ECOFIN can still use the terms ' the Group' and 'broad consensus':
  - in the case that all MSs (minus the one MS concerned) share an opinion;
  - in other cases where MSs, other than the MS concerned, have a dissenting opinion, and none of these MSs oppose the use of the wording 'the Group' and 'broad consensus' (e.g. in case MSs might technically object to an evaluation of a measure but do not politically object to the end result of the Group at ECOFIN level).
- In case the Group does not reach 'broad consensus', the Chair could consider calling for an additional Code of Conduct Group meeting where all MSs will be urged to participate at high level (political) as is foreseen in paragraph 11 of Council Conclusions concerning the establishment of the Code of Conduct Group (9 March 1998, 98/C 99/01), with the aim of having a more political discussion (and perhaps solve any problem that the Group could not solve on a more technical level). Such a Code Group meeting could also address more general Code issues, not specifically relating to a measure, in preparation for the ECOFIN Council.

- In case “broad consensus” can’t be reached, the report to ECOFIN could then express the various views mentioned, indicating the number of MSs 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.
- In order to raise more awareness of the Code of Conduct at the level of Ministers and our present work, an ECOFIN Council meeting with the Code on the agenda could be used to re-affirm the commitment of all MSs to combat harmful tax competition and make clear that in future more discussions will follow at ECOFIN (whereas in the past most Code reports passed as a I/A item).

**3. Situations where measures are affected by State aid proceedings**

- Paragraph J of the Code states that some of the tax measures covered by this code may fall within the scope of the provisions on State aid. However, the paragraph does not provide any procedure for the fact that both State aid proceedings and Code of Conduct discussions can take place in ‘parallel’.
- The Group could consider that, in cases where a measure is part of an ongoing State aid procedure (after the formal opening of the State aid procedure), the Group will suspend the Code of Conduct discussion until the State aid procedure has taken its course (including any eventual Court proceeding). A preliminary description of the measure, drafted by the Commission in close consultation with the MS concerned, can already be provided to the Group. A final (possibly revised) version of a description should be provided immediately after the end of the State aid procedure, if need be.
- The Group should be reminded that a Code of Conduct evaluation is not necessarily the same as a Commission State aid decision (or vice versa). The two procedures are separate and follow their own set of rules and criteria. MSs should therefore explicitly recognize that a COM State aid decision does not affect the outcome of a Code of Conduct evaluation (and vice versa).

**Annex to ANNEX I: Code of Conduct comparability table**

| | Code of Conduct elements | Comparables |
|---|---|---|
| | | |
| A | Affects business location | Which type of business or income is covered by the regime?<br><br>Does the measure attract genuine economic business or artificially shiftable mobile tax bases?<br><br>Attraction of tax bases of other MSs? Can the tax base easily be shifted (mobility)?<br><br>Is the measure targeted at MNEs (intra group)? |
| B | Lower level of taxation | Design of the reduction of the tax base or rate |
| 1a | Benefits accorded to non-residents or transactions with non-residents | To what extent does the measure, de jure, benefit foreign-owned companies. |
| 1b | De facto | To what extent does the measure, de facto, benefit foreign-owned companies.<br><br>Impact assessment required, economic effects.<br>(e.g. number of foreign owned companies benefiting as a percentage of total companies benefiting)<br>(The Group could consider interpreting the economic impact data in relation to differences in size of country or market and openness of the economy of that MS (to be developed by the Group). |
| 2a | Protection of the tax base | Does the measure affect the domestic tax base? Is the domestic tax base protected in any way? If yes, in which form?(e.g. no domestic companies allowed or limitation of deductibility of transactions with domestic companies). |
| 2b | De facto | To what extent (budgetary) is the domestic tax base protected?<br>Impact assessment needed, economic effects |
| 3 | Substance | Which substance requirements are in place?<br>Personnel, investments in fixed assets, other. |
| 4 | Profit determination (transfer pricing) | OECD Transfer Pricing Guidelines<br>- fixed margins vs case by case approach<br>- periodical review of the transfer price<br>- exchange of information |
| 5 | Transparency | Procedure for granting of the benefits (discretionary powers?) |
| C | Other elements: | Such as general tax environment, to the extent that it is relevant for the measure under consideration.<br>(e.g. general tax rate, deviation of the incentive from the general tax rate, historic context of the tax measure which is used for the claim of precedence, or how the activities concerned are effectively taxed throughout the Community (paragraph G of the Code)) |

## FUTURE WORK PACKAGE

WITHIN THE EXISTING MANDATE OF THE CODE

In addition to the ongoing work on monitoring standstill and the implementation of rollback, the Code of Conduct Group proposes to take forward the programme of work within the existing mandate as set out at (1) to (6) below. The Group considers that it should be able to complete this programme of work over the next eighteen months under the Portuguese, Slovenian and French Presidencies.

(1) **Procedure and the role of precedence and comparability**

In accordance with the conclusions of the Council of December 1997 considering as potentially harmful a tax measure which provides for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question and while not reopening assessment of measures that have been finalised, the Group would reflect on the pros and cons of relying purely on precedence, or of considering each measure in isolation, or alternatively somewhere in between.

The Group would also explore how it might be possible to improve the way it works within the context of the Council Conclusions of 9 March 1998, including the way conclusions are reached.

(2) **How the Group copes with the situation where measures are affected by State aid proceedings**

The Group would discuss the interaction of State aid proceedings and evaluation under the Code to see whether there is any scope for better managing the interaction.

(3) **Anti-abuse**

While noting the Commission's work on coordination in this area, the Group would discuss what potential there is for a common political understanding of the latest position in European law and in particular what 'genuine economic activity' means within the context of anti-abuse rules in the EU.

(4) **Transparency and exchange of information in the area of transfer pricing**

The Group would follow up on the Group's work in 2002 on transparency and exchange of information in the area of transfer pricing, and discuss the extent to which the agreed proposals set out in Annex 2 of the report to the ECOFIN Council of 26 November 2002 (14812/02) have been reflected in Member States' practices.

(5) **Administrative practices**

Preceded by a comparative study on transparency of administrative practices, the Group would revisit the work done in 1999 when Member States provided comments on a comparative study across Member States of administrative practices in taxation, and discuss the extent to which Member States' administrative practices, including practices at regional or local level, relax measures to the point that they may be considered harmful.

(6) **Links to third countries**

With regard to the first paragraph of Paragraph M of the Code on the promotion of the adoption of the principles of the Code of Conduct in third countries, the Group would explore the potential ways to help Member States to increase their influence in this respect.