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OUTCOME OF PROCEEDINGS

From: General Secretariat of the Council
To: Code of Conduct Group (Business Taxation)
Subject: Cook Islands' Development Projects regime (CK006)
– Final description and assessment

ROLLBACK REVIEW PROCESS (JANUARY 2020)

On 17 December 2020 Cook Islands adopted the Development Investment Amendment Act 2019 (see doc. 7422/2020 ADD 1), Development Investment Amendment Regulations 2019 (see doc. 7422/2020 ADD 2) as well as Income Tax Amendment Act 2019 (see doc. 7422/2020 ADD 3). These acts repeal CK006 as of 1 January 2020.

The Code of Conduct Group (business taxation) (COCG) meeting of 4 February 2020 approved the rollback of the regime. This conclusion was endorsed by the ECOFIN Council on 18 February 2020.

ADD 1: Development Investment Amendment Act 2019

ADD 2: Development Investment Amendment Regulations 2019

ADD 3: Income Tax Amendment Act 2019

Annex 1: Assessment of the CK006 regime in 2017 (standstill)

Explanation

The Development Investment Amendment Act 2019 repealed Section 27A of the Development Investment Act 1977, which provided a tax exemption for certain incentives and concessions. No grandfathering will be applied for the regime. Income Tax Amendment Act 2019 repealed section 42(1) (j) (exempt income). Based on the amendments introduced, the regime should be considered as abolished.

Assessment of the CK006 regime in 2017 (standstill)

Development Projects (CK006)

a. Description

Under Section 42 (j) of the Income Tax Act the following income is exempt from taxation:

“income derived by any society or association whether incorporated or not, which is in the opinion of the Collector, established substantially or primarily for the purpose of advertising, beautifying, or developing any island, village, or other district so as to attract trade, tourists, visitors, or population, or to create, increase, expand, or develop amenities for the general public, if no part of the income or other funds of the society or association is used or is or may become available to be used for any other purpose, not being a charitable purpose;”

b. Preferential features

The income is exempt from taxation if “in the opinion of the Collector” fulfils the purpose set down in Section 42 (j) of the Income Tax Act. The normal tax rate is 20 %.

c. Possible concern:

An important criterion used to assess the harmfulness of a regime under the Code of Conduct, is its transparency (criterion 5 of the Code of Conduct). A measure is considered as not transparent when it is not laid down in law but granted on a discretionary basis. This regime does not seem transparent to the extent that the benefits may be granted only if the purpose is fulfilled “in the opinion of the Collector”. This leaves an important discretionary power to grant the benefits.

d. Assessment

| | 1a | 1b | 2a | 2b | 3 | 4 | 5 |
|---|-----------|-----------|-----------|-----------|----------|----------|----------|
| The Cook Islands – Developing Projects | X | ? | X | ? | V | X | V |

Explanation

Gateway criterion - Significantly lower level of taxation:

“Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code”

The general tax rate for companies in the Cook Islands is 20%.

Under Section 42 (j) of the Income Tax Act the following income is exempt from taxation:

“income derived by any society or association whether incorporated or not, which is in the opinion of the Collector, established substantially or primarily for the purpose of advertising, beautifying, or developing any island, village, or other district so as to attract trade, tourists, visitors, or population, or to create, increase, expand, or develop amenities for the general public, if no part of the income or other funds of the society or association is used or is or may become available to be used for any other purpose, not being a charitable purpose;”

The income is exempt from taxation if “in the opinion of the Collector” fulfils the purpose set down in Section 42 (j) of the Income Tax Act.

The measure therefore provides for a significantly lower level of taxation and is potentially harmful under the Code.

Criterion 1 – Targeting non-residents:

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

The measure is *de lege* available to both residents and non-residents and does not require that the beneficiaries carry out transactions only with non-residents. We would therefore propose a cross (“X” - not harmful) for criterion 1a). There is no data available to show in which cases (e.g. foreign/domestically owned companies) the tax benefits have been granted. We would therefore propose a question mark (“?”) for criterion 1b).

Criterion 2 – Ring-fencing:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

The measure is *de lege* available to both residents and non-residents and does not require that the beneficiaries carry out transactions only with non-residents. By analogy to the assessment against criterion 1a, we would propose a cross (“X” – not harmful). Since there is no data available to show in which cases (e.g. foreign/domestically owned companies) the tax benefits have been granted, we would therefore propose a question mark (“?”) for criterion 2b).

Criterion 3 - Substance:

“whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages”

The measure does not include any express requirement for real economic activity or substantial economic presence. We would therefore propose a tick (“V” - harmful) for criterion 3.

Criterion 4 – Internationally accepted principles:

“whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”

A tax exemption does not contradict any internationally embraced principle. We would therefore propose a cross (“X” – not harmful) for criterion 4.

Criterion 5 - Transparency:

“whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way”

This regime does not seem transparent to the extent that the benefits may be granted only if the purpose is fulfilled “in the opinion of the Collector”. This leaves an important discretionary power to grant the benefits.

The Cook Islands argues that the legislation follows the Pemsel Case, Commissioners v Pemsel [1891] AC 531, which has been used widely by Commonwealth and common law jurisdictions. In order to be eligible for the tax benefits, the society or association has to be charitable in its purpose. If the sole purpose of the entity is charitable then the entity will be considered a charity and it is likely that it will be exempt from income tax, under the condition that it is established and maintained exclusively for charitable purposes and not carried on for the pecuniary profit of any individual. The criteria must be met in order for the exemption to apply.

Although the arguments of the Cook Islands could be considered to be valid, these principles are not laid down clearly in the legislation. This leaves the possibility open for the Collector to grant tax benefits to companies at his own discretion. We would therefore propose a tick (“V” – harmful) for criterion 5.

Overall assessment

“Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community”

In light of the assessment made under all Code criteria, the regime should be considered overall harmful from a Code of Conduct point of view.

The main concerns which deviate from the Code of Conduct criteria relate to:

- The measure **does not include any express requirement for real economic activity or substantial economic presence.**
- This regime does not seem transparent to the extent that the **benefits may be granted only if the purpose is fulfilled “in the opinion of the Collector”**. This leaves an important discretionary power to grant the benefits.