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REPORT

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

Costa Rica's manufacturing activities under the Free Zones regime (CR002):

Final description and assessment

STANDSTILL REVIEW PROCESS (JANUARY 2019)

The OECD Forum for Harmful Tax Practices (FHTP) assessed Costa Rica's Free Zones (CR001)[1] regime at its meeting in January 2019 and concluded that the regime is amended (not harmful). However, a footnote explained that the regime should be considered not harmful subject to the final adoption of the legislation. This outcome was not in line with the practice of the Code of Conduct Group (COCG) that considers that a regime is rolled back only when the legislation is adopted. Therefore, the conclusion of the FHTP could not be endorsed and the CR001 regime was assessed by the COCG meeting of 30 January 2019.

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[1] De facto added under the COCG monitoring process in April 2018 though not included in Annex II in December 2017: see doc. 14364/18.

At the same meeting, following its standard procedure, the COCG however also agreed to identify Costa Rica's manufacturing activities under its Free Zones (CR001) regime as a new regime (with the code: CR002). For this reason, the assessment agreed at the COCG meeting of 30 January 2019 (in copy below) de facto covered both regimes: the rollback assessment of the CR001 regime and standstill review assessment of the CR002 regime.

For memo, the ECOFIN Council at its meeting of 12 March 2019 subsequently endorsed the conclusion that Costa Rica should be granted a deadline extension until end 2019 for reforming its Free Zones (CR001) regime, considering that it mainly covers non-highly mobile activities such as manufacturing - even though this part of the regime had been identified as a new regime. For this reason Costa Rica was included in section 2.1 of Annex II with a deadline of end 2019 for both regimes (CR001 and CR002).

The justification can be found in paragraph 7(1) of the Council conclusions of 12 March 2019: "*certain developing countries should be given more time to reform their harmful preferential tax regimes covering manufacturing activities and similar non-highly mobile activities considering the heavier economic impact of these reforms on such countries*".

COCG assessment:

	1a	1b	2a	2b	3	4	5
Costa Rica– Free (Trade) Zones regime (CR001 and CR002)	V	?	V	?	X	X	X

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 standard corporate income tax rate is 30%. Companies applying to the regime receive a full tax exemption on CIT. 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*"

Art. 17 of Law 7210/1990 excludes resident companies from the companies that the beneficiaries of the regime can have transactions with.

Criterion 2 – Ring-fencing:

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

The considerations under criterion 1 can apply by analogy to criterion 2.

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*"

According to the standard practice for the evaluation of a measure against criterion 3, a measure is found harmful under this criterion if there are no specific requirements with regard to real economic activities and notably any requirement with respect to employment obligations.

The measure includes explicit requirements for real economic activity or substantial economic presence, in particular with regard to job creation.

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*"

The measure does not contradict any internationally embraced principle.

Criterion 5 - Transparency:

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

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations etc. before a measure can be considered transparent.

The measure is fully set out and published in the relevant legislation and the practice should not involve any administrative discretion.

Grandfathering

Costa Rica did not avail itself of any grandfathering period.

Overall Assessment

In the light of the assessment made under all Code criteria, the two regimes are considered as harmful under the Code of Conduct.