COUNCIL OF
THE EUROPEAN UNION

Brussels, 19 May 2006

9655/06

LIMITE

FISC 73

REPORT

from :	the Code of Conduct Group (Business Taxation)
to :	the ECOFIN Council
on :	7 June 2006
Subject :	Code of Conduct (Business Taxation) Report to the ECOFIN Council

INTRODUCTION

1. The Council and the Representatives of the Governments of 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 66 measures were considered harmful by the Group.

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 in the acceding states found harmful under the Code. The Council also agreed on the adequacy of the rollback measures envisaged or already undertaken for 27 of these measures.

5. This report from the Code Group encompasses the work of the Code Group in 2006 under the Austrian Presidency.

6. As required by the ECOFIN conclusions of 9 March 1998, the Group's report to the 29 November 1999 ECOFIN Council reflected either the unanimous opinion of the members of the Group or the various opinions expressed in the course of discussion. References to 'the Group' in that report reflected the broad consensus where unanimity was not achieved and alternative views were shown in the notes as appropriate. Consistent with the Group's report to the 29 November 1999 ECOFIN, references to 'the Group' in this and other reports should be construed in the same way.

PROGRESS OF WORK

7. The Code of Conduct Group met on 28 March 2006, 27 April 2006 and 16 May 2006 under the Austrian Presidency.

8. At the meeting on 28 March, Mr Wolfgang Nolz, Director General of Taxes and Customs at the Ministry of Finance in Austria, and Mr Lasse Arvela, Director General of Taxation in the Ministry of Finance in Finland, were confirmed as the first and second Vice-Chairs respectively for the period up to the end of the Austrian Presidency. The Group also confirmed a programme of work under the Austrian Presidency, agreeing to take forward work in the following three areas:

(a) implementation of rollback;
(b) standstill;
(c) further discussion on the future of the Code of Conduct.

9. At the meeting on 27 April, Mrs Primarolo was re-appointed by common accord as Chair of the Code of Conduct Group for a period of two years from 8 May 2006.

Implementation of rollback

10. Malta (Rollback of measures ML4 and ML5): The Code Group also continued its work on the rollback of Malta's measures (International Trading Companies (ML4) and Dividends from (other) Maltese Companies with Foreign Income (ML5)).

11. At its meeting on 28 March, the Group considered an initial draft description of a new rollback proposal which had been prepared by the Commission services in consultation with Malta. Following further discussion on 27 April, the Group requested Malta to provide information on its proposed anti-abuse measures.

12. Following discussion on 16 May on information from Malta on Malta's proposed anti-abuse provisions, the Group agreed that work on the evaluation of Malta's proposed rollback should be moved on to the next stage. It was agreed that the Commission Services will produce an agreed description as well as an initial assessment against the criteria in paragraph B of the Code for consideration by the Group at its next meeting.

13. To facilitate the Code Group's work on the implementation of rollback, each Member State was asked to provide information on developments since December 2005 on the implementation of rollback of measures in its name on the list in Annex C of SN 4901/99 (or, in the case of the ten Member States which acceded on 1 May 2004, the measures listed as harmful in the Annex to the Enlargement Group (Tax Experts) report of 3 October 2003 to the Permanent Representatives Committee and to the Council (13213/03 ELARG 94 FISC 138).

14. At its meeting on 27 April, the Group was provided with information on all developments since December 2005 on the implementation of rollback.

15. The Group was informed that:

- Belgium's Distribution Centres (A002) and Service Centres (A003) measures had been abolished, with the details announced on 20 September 2005;

- Netherlands' International Group Financing Regime (B004) had been abolished as of 1 January 2006;

- In line with the rollback description in the Annex to 14361/03 FISC 173:
  - F028 (Exempt Companies – Aruba) had been abolished by a law approved on 6 December 2005;
  - a law amending excluding financial activities from F030 (Free Zones – Aruba) had been approved on 6 December 2005;
  - a legislative proposal excluding financial activities from article 1 of the State Ordinance Free Zones (F024: Free Zones – Netherlands Antilles) was currently pending. Once approved, this would have retroactive effect to 1 January 2006

- as set out in the Code Group report dated 26 November 2002 (14812/02):
  - F046 (UK: Jersey – International Treasury Operations), F047 (UK: Jersey – International Business Companies) and F048 (UK: Jersey – Captive Insurance Companies) had been abolished by 31 December 2005 (with the agreed extension of benefits to 2011 for F047).
  - the measures listed below are being abolished by a Bill likely to become law in May 2006 which will have effect from 6 April 2006:
    - F061 (UK: Isle of Man - International Business Companies)
    - F062 (UK: Isle of Man - Exemption for Non Resident Companies)
    - F063 (UK: Isle of Man - Exempt Insurance Companies)
    - F065 (UK: Isle of Man - International Loan Business)
    - F066 (UK: Isle of Man - Offshore Banking Business)
    - F067 (UK: Isle of Man - Fund Management).

16. As reflected in the Group's reports to ECOFIN in December 2004 and June 2005, the Group had requested that the UK should submit a revised rollback proposal for measure B012 (UK: Gibraltar - Exempt (offshore) Companies and Captive Insurance), in particular relating to not having new entrants in 2005 noting that the measure should have been closed to new entrants in 2001. The UK explained that there was no viable alternative to the roll back proposal which followed the Commission appropriate measures decision under State aid rules, formally accepted by the UK and the Government of Gibraltar, and according to which the Government of Gibraltar is committed to the phased abolition of B012, with a reducing number of new entrants until June 2006 and existing beneficiaries able to continue to benefit from the regime until the end of 2010. The Group expressed its continuing dissatisfaction with the failure to fulfil the commitment to rollback measure B012.

Standstill

17. Member States are committed not to introduce new tax measures which are harmful within the meaning of the Code. In view of this ongoing commitment, at the Code Group meeting on 28 March, Member States were invited - in accordance with the Group's established practice - to assist the Group in its work by notifying to the Commission services any new measures which potentially fall within the scope of the Code of Conduct and which have been enacted in the twelve months to end-January 2006.

18. Four new measures were notified to the Group:

- Poland: Changes to regulations on Special Economic Zones;
- Slovenia: Enlargement of the period for a loss carry-over;
- Slovenia: Relief for investment in research and development;
- Slovenia: Harmonisation with the amendments to the Mergers Directive.

19. The Group requested the Commission Services to prepare descriptions of the above-mentioned measures in consultation with the Member States concerned.

Future of the Code of Conduct

20. The Code Group continued its discussions on the future of the Code of Conduct. The Code Group has, of course, no remit to decide its own future. The Code Group's progress on its considerations is nevertheless summarised in paragraphs 22 – 27 below.

21. Written contributions provided by a number of members of the Group setting out their views on the future of the Code are attached in Annex.

22. The Group's considerations on the future of the Code of Conduct have focused on four broad areas:

- continuing to monitor rollback and standstill;
- extending the work of the Group (whether within the existing scope of the Code or by formal extension of the mandate);
- the procedures of the Code Group;
- the future pattern of work of the Group.

23. Continuing to monitor rollback and standstill: There was almost unanimous support from members of the Group for the work on monitoring rollback and standstill to continue in future. An important consideration here was the need to maintain the achievements made by the Code of Conduct Group since 1998 and to pay particular attention to standstill and to the effective implementation of rollback.

24. Extending the work of the Group: A wide range of views was expressed on whether or not the work of the Group should be extended either within the existing scope of the Code or by formal extension of the mandate. For instance, some members of the Group indicated that they were in favour of a formal extension of the mandate to some new areas (for example, to personal taxation or to dividend taxation). Other members of the Group were opposed to any extension of the Group's work.

25. The procedures of the Code Group: A range of views was expressed on the decision-making procedure of the Group. For example, some members of the Group were in favour of more restrictive rules. Others were of the view that decisions should continue on the basis of the existing arrangements, the concern being that any hardening of these would hinder decision making by the Group. There was also a range of views on the Code criteria and on the issue of precedence. For instance, some expressed concern about sub-criteria 1b and 2b. Others were of the view that the existing criteria should be maintained.

26. It was suggested that the Group should give further thought to the relationship between the Code and the State Aids rules. For instance, given the Commission's discretion over State Aids, it might be helpful to clarify to what extent the Group can and should pursue work on a measure which was affected by State Aids proceedings. It was also suggested that the Group should facilitate its work under the Code by looking at anti-abuse measures and exit taxation for companies.

27. The future pattern of work of the Group: Various views were expressed. For example, the Code Group as a high level group coupled with the occasional use of technical Code subgroups had proved to be a good way to work. However, it was possible on occasions that fewer high level meetings per Presidency might be sufficient to cover the work.

ANNEX

Austria

Procedural rules

The Code of Conduct Group regularly forwards reports on the progress of its work to the Council. The Council Conclusions of 9 March 1998 by which the Group was established provide for that these reports should either reflect the unanimous opinion of the group or the various opinions expressed in the course of the discussion. It is further stated that any further rules of procedure may be established.

In its present work the group concentrates on rollback and standstill. Currently, there are no procedural rules how the report to the Council shall be drafted, if a majority of Member States evaluates rollback measures of a certain Member State as being not sufficient or a new measure as being harmful. It could be agreed that in such a case the rollback is reported as being not adequate or a regime as being harmful, if a qualified majority (e.g. two third of the Member States) share this point of view. Member States which are of a contrary view could be mentioned in a footnote, but the minority cannot impede the evaluation of a tax measure as being harmful in the report .

Soft law for regimes concerning passive income

Currently there are regimes concerning the taxation of passive income in Member States which are very advantageous and, therefore, decisive for the location of investment. As a reaction to this fact other Member State are forced to introduce counter-measures in order to combat the location of capital to such jurisdictions. By nature, such counter-measures will constitute in most of the cases an infringement of the basic freedoms of the Treaty according to the principles developed by the ECJ in its relevant decisions.

Therefore, the Group could evaluate regimes of the taxation of passive income and try to draft a sort of guidelines for the tax treatment of passive income (comparable to the Holding Guidelines).

Belgium

At the meeting held on 18 October 2005 under Mr Nolz's chairmanship, it was suggested that delegations should submit their views on the future of the Code of Conduct of 1 December 1997 and of the Code of Conduct Follow-up Group.

It seems right to wonder about the usefulness of any further proceedings by the Group as the latter is about to complete all its work as defined in its mandate from the 1998 ECOFIN Council.

Considerable work has been done and the "dismantling" target can at present be regarded as having been attained, including for the 10 new Member States which acceded in May 2004. As regards the "freeze" component, all Member States undertook at political level to observe the principles of fair competition and to refrain from adopting any harmful fiscal measures. This political commitment on the part of the Member States should obviously be renewed.

If the Group were to continue its work with a new mandate, Belgium would want to avoid a situation whereby this new or amended mandate led to extensions which would fail to take proper account of the special circumstances obtaining in those Member States whose internal market is limited and which have geared their economies towards the outside world with a view to making them as active as possible. Such opening-up should moreover be seen entirely in the context of the large market whose implementation was already provided for in the Single Act of 1986.

In this connection, you will remember the extensions to criteria 1 and 2 of the Code of Conduct which occurred as soon as the Follow-up Group started its work on the Code. At that time, Belgium did not wish to obstruct the Group's work and therefore, reluctantly but in a spirit of cooperation, supported the majority view. In the end it appeared that extended criteria 1b and 2b were not always regarded as secondary criteria and that some Member States even regarded them as decisive in making an unfavourable assessment of a system under review.

A repeat of such a situation should in future be avoided at all costs. This is why I could no longer go along with an interpretation of the Code of Conduct by the Follow-up Group which would result in work not directly provided for under the Code.

As regards a new or amended mandate to be given to the Group, it seems to me that the present circumstances are in many respects different from those which in 1997 and 1998 enabled 15 Member States to reach agreement on the Code of Conduct and on the Follow-up Group's mandate. The Code of Conduct was indeed one component of a fiscal package in which each Member State could find both favourable and unfavourable aspects. I wonder whether at this point in time, every Member State could find elements in a new or amended mandate which might gain its support. I admit I am rather pessimistic about this possibility.

Moreover, since the Code of Conduct Group started its work, the Commission has - in parallel with our Group's work - considerably stepped up its control in the area of fiscal State aid. At present the Commission is making full use of the powers conferred upon it by the Treaty in order to halt any fiscal measures likely to constitute harmful fiscal competition. In this respect I refer to the Commission's 2004 report on the implementation of its 1998 communication on the application of the State aid rules to measures relating to direct business taxation. It is difficult not to see these activities as being completely in parallel with those of our Group, and thus a duplication of work.
This being the case, and taking account of the amount of work already done, of the Commission's policy regarding State aid and of the aforementioned political commitment, I wonder whether further work by the Follow-up Group is still indispensable at this juncture. Belgium believes it is not and that in any case if - contrary to our opinion - the Group were to be maintained, the frequency of its meetings should be considerably reduced.

Cyprus

In reply to the request of providing written observations regarding the discussion on the future of the Code of Conduct Group, following the Group meeting on 18 of October 2005, hereby are the comments of Cyprus:

Cyprus highly values the Group's contribution to the process of elimination of harmful tax practices in European Union. We believe that the existence of the Group is important and should continue to contribute at the same level on the foreseeable future, in order to provide Member States with substantial benefits.

However, we must point out that the participation of Member States should be at the highest technocratic level in order to benefit from these meetings at all times.

Czech Republic

As far as the future work of the Code of Conduct Group (hereinafter only "the Group") is concerned, from our point of view the activity of the Group has still contributed to the elimination of certain national harmful tax practices within the European Union. Hence the further existence of the Group is substantiated.

We believe it would be appropriate to set down certain procedural rules for the Group's meetings, e.g. to fix quorum necessary for the acceptance of the Group's decision.

Furthermore, in this connection it would be useful to specify the relation between the former Group's decisions and the future ones more closely.

Estonia

Estonia values highly the accomplishments of the Code of Conduct Working Group in decreasing the harmful tax competition. Estonia finds that a forum where member states' laws are harmonized via cooperation should exist at certain level. For those reasons does Estonia not oppose the continuation of the working group. Code of Conduct Working Group is one of the options for member states to solve problems among themselves, especially considering the aspect of the receipt of tax revenue.

The working group is a certain alternative for the negative harmonization proceeded by the European Court. Even though the forum does not completely solve the problems, it is still a part of solution.

Finland

Finland values highly the achievements of the Code of Conduct Group, and therefore believes the work on monitoring standstill and rollback should continue. However, in view of the amount of remaining work, it could be considered whether the frequency of the meetings should be reduced, and whether at least some of the work could be done by a subgroup of technical experts. Whether this subgroup should be chaired in the same way as the Group itself or perhaps by the Commission, could be discussed by the Group.

We are at this time not convinced that any changes regarding the scope of the Code or its assessment criteria are either necessary or politically feasi-ble. If however, a large majority of the Member States deems such changes necessary, we could perhaps reconsider our position.

In the case of significant changes regarding the substantial scope of the Code, the procedural rules and perhaps the Code criteria as well should in our view be re-examined, taking also into account the recent difficulties in reaching decisions on the basis of a broad consensus. If no substantial changes to the scope are made, we do not consider it necessary to review just the procedural rules and the Code criteria.

Results so far show that the Group's work has made a significant contribution to the implementation of the code of conduct. If the same is to apply in the future, we have to continue with our efforts. The Code of Conduct Group should therefore remain committed to the rollback and standstill process in the future as well.

Future topics

The aim of the Code of Conduct is to refrain from introducing any unfair tax measures which may harm or distort a decision on the location of business activity. Future discussions within the Code of Conduct Group should therefore also cover all tax measures of Member States which have a distorting effect on company decisions concerning the location of their business activities. An isolated approach based solely on company taxation does not go far enough. The study should rather include the complete set of measures constituting the taxation of companies. Particular mention should be made here of the taxation system for the boards of directors of companies and for especially highly qualified staff. The Code of Conduct Group should therefore look in future at the tax measures applicable to so-called expatriate staff.

The same applies to the taxation of shareholders in companies. The possible unfair effects of a system of taxation for companies cannot be fully determined unless the evaluation also includes the taxation of shareholders as well as the taxation of the company itself. These issues therefore need to be discussed in the Code of Conduct Group as well.

Procedure

The reports of the Code of Conduct Group to the Council should currently reflect either the unanimous opinion of the Member States or their differing views. The impact of a report will be all the greater if the report sets out the majority view of the Member States and any divergent opinions of other Member States are recorded in footnotes.

Greece

In response to the request for written observations regarding the discussion on the future of the Code of Conduct Group, as suggested at the meeting held on 18 October 2005 under Mr Nolz's chairmanship, we would like to make the following comments:

Greece highly appreciates the work carried out by the Group and its contribution to the elimination of harmful tax regimes and practices in the EU. We believe that its work is important and should continue to support the aim of fair tax competition within the EU.

In addition we believe that the Group should continue its work concerning rollback and standstill along the lines that we have done so far. However we would like to mention that equal treatment of all Member States should be the primary concern in the Group's future work.

Finally, taking into account of the amount and the importance of work already done, Greece is of the opinion that the Group should be maintained to continue its current work at the highest level of standards.

Hungary

The discussion about the future of the Code of Conduct Group is one of the main issues of the next Code Group meeting. We think that this is an opportunity to have a real debate on how the work can become even more effective and the decisions of the Group as fair as possible.

We think that the application of the two "de facto" criteria (1b and 2b) of the Code should be reconsidered. It is questionable whether these indicators provide any information about the harmful tax competition or solely show the openness of an economy. As the use of these criteria can lead the Group to wrong conclusions, we think that both should be deleted.

During the last meetings the Group realized that procedural rules and best practices established for 15 member states can not be applied to the enlarged EU. Therefore, it would be appropriate to set down new procedural rules, e.g. to define how many countries constitute the "vast majority". Alternatively, agreement on the voting rules (especially on the majority rule) could also provide for a more reliable background.

Finally, we think that the problem of precedent is also to resolve. We would need a clear guidance on how to consider cases which had been accepted by the Group but have some element on the basis of which the measure should have been considered harmful. Can these measures be used as a precedent taking into account the principle of equal treatment or rather should we re-open them in order to avoid bad practices? We think that this problem should also be discussed during the meeting.

Ireland

We have been asked to let you have our views on the future of the Code of Conduct Group.

We value the work of the Group as a solid example of what can be achieved by cooperation on a case by case basis to seek to eliminate sources of contention between the Member States in the tax area.

That spirit of cooperation is, of course, a function of the remit of the Code. To extend that remit to matters outside the Code such as issues of personal taxation whether at director, senior employee or shareholder level in a firm is to cross over into areas for which member State Governments are directly and clearly accountable to their own electorates. For these and other reasons, we do not favour any extension of the Code beyond its current parameters.

The Group itself might sec some value in looking to see if its decisions on particular regimes and practices are being applied evenly in the Member States. In this regard I would emphasise the continued importance of the work on standstill. It might also see if it should focus its work more on the requirement to notify changes to administrative practices and regimes. I mention this latter point because there seems to be a growing desire for firms to get advance clearance for their tax actions from tax authorities so that they can better comply with the new focus, and legal provisions, on company ethics and corporate governance. This should *not* be taken as suggesting any requirement that Member States seek clearance for measures from the Code Group *before* the measures are introduced.

We also agree with others that in assessing the future need for the Group we should take into account the greatly changed context since 1997 - as evidenced by the Commission's increased focus on state aid issues and following up cases at the ECJ on tax matters generally.

Latvia

In reply to request of providing written observations regarding the discussion on the future of the Code of Conduct Group we would firstly like to assure that Latvia appreciates efforts of the Group made until now to eliminate harmful tax practices within European Union.
In our opinion the activity of the Group should be continued in future at least for certain period of time.
At the same time, we believe that the procedure according to which the Group comes to a conclusion should be clarified to reflect fully the fact that any Group's decision is a result of a political consensus based on clear support of all delegations.

Lithuania

In reply to request of providing written observations regarding the discussion on future of the Code of Conduct Group following the Group meeting on 18 of October 2005 we would firstly like to welcome the fact of Group's significant contribution to the process of elimination of harmful tax practices in the EU member states.

Additionally, taking into account the work of the Code of Conduct Group on the assessment of potentially harmful tax measures, we would like to express our view regarding the application of specific criteria established in the Code of Conduct for determining whether tax regime measures fall within the scope of harmful or potentially harmful tax practices, particularly criteria 1 establishing the requirement to asses whether advantages are accorded only to non-residents, or in respect of transactions carried out with non-residents, and criteria 2 establishing the requirement to asses whether advantages are ring-fenced from the domestic market so they do not affect the national tax base. Taking into consideration standard practice of the Code of Conduct Group, criteria 1a and 2a concern *de jure* application of the tax measure whereas criteria 1b and 2b is connected with *de facto* application of the tax measure.

We are of the view that *de jure* application of the specific tax measure is a decisive element determining whether the tax measure is harmful whereas the factual application of the tax measure served as an indication of openness of the economy, which facilitate the investment opportunities and competitive climate in the region. Thus in order to prevent uncertain results of the assessment, we take the view that in the future the basis to determine whether the tax measure is harmful should be *de jure* application of the specific tax measure.

Netherlands

Summary

The Presidency has asked Member States to express their views on the future of the Code of Conduct Group on Business Taxation. In the opinion of the Netherlands, starting point of all discussions on the future work on EU tax policy must be the Lisbon Agenda. The goal of the European Union is to become the most competitive, dynamic and innovative economy. It is evident that with respect to corporate taxation, significant steps can be made to improve the functioning of the internal market. A level playing field is an essential element of such an internal market. This can only be achieved if it is based on transparent rules that apply to all member states. Only then equal treatment for companies as well as member states can be guaranteed.

According to the Netherlands, soft law does not fit in this approach. Soft law, by definition, cannot guarantee a level playing field. For the future, the focus should be on minimum common standards, based on actual legislation (if necessary on the basis of enhanced corporation). This s the only way forward in the tax arena, to achieve a sustainable7 framework of common tax rules, thereby improving the functioning of the internal market.

Therefore, the Netherlands are of the opinion that:

• Future work should concentrate on establishing EU legislation on minimum common standards.

• Soft law, like the instrument of the Code of Conduct, does not fit in this approach.

• Thus, the Netherlands see no future in extending the mandate of the Group, in neither time nor scope. The remaining work on monitoring standstill and rollback could be reassigned to a technical sub-group chaired by the Commission.

Observations

A political group cannot guarantee impartiality

The most important shortcoming of the Code of Conduct Group is that it is a political rather than a legal instrument. As a consequence, there has been too much room for compromises at certain stages. This can lead and has to a considerable extent led to arbitrariness in assessing potentially harmful tax measures. Another consequence is that the Group cannot guarantee adequate execution of its condemnations. Agreed rollback proposals have been implemented too little, too late, or even not at all and have been allowing for new entrants, without any (political) consequence.

The rules in a political context are not always clear

It has proven to be difficult to make a strict distinction between harmful and fair tax competition, amongst others because the criteria of the Code do not encompass economic realities. For instance, the Group has been reluctant to take into account the different scales of economies in member states. Smaller countries with open economies will have a relatively larger share of foreign owned companies, than larger member states with a respectively larger domestic market. Technically equal measures in different member states will therefore be treated differently, especially in assessing measures with respect to paragraph B, criteria 1 and 2 of the Code. Furthermore, in member states experiencing economic growth, the effects of a certain measure will always be increasing, whereas these effects will decrease when the economy is slowing down. As a consequence of the fact that differences in size and economic development of member states were not taken into account, the rules of the Group did not (always) lead to impartial conclusions. These differences have never been fully explored by the group.

Third countries

The Group has been too inwardly focused and has been oblivious to the economic realities of third countries. Instead of accepting the fact that there is a need for different treatment of (increasingly) mobile capital in the EU as a whole and discussing a comprehensive common approach the group has focused on a limited number of regimes that were under State aid procedure anyway. Instead of increasing the European competitiveness and contributing to the Lisbon Agenda, the Group has chosen an approach that may inadvertently have lead to a weakening of the EU economy. The Group has offered no alternative, and by doing so has left third countries to profit.

State aid

Since the formation of the Code of Conduct Group, the State aid measures have matured as an instrument against selective tax measures. The Commission has issued a communication and case law has developed. State aid procedures have become more effective and have proven to be an adequate instrument in realising a level playing field. Most regimes that have been fully abolished by the Group's initiatives are regimes that were condemned in State aid procedures anyway.

Conclusion

The Code of Conduct was part of the Tax Package, which is now largely completed. The Interest & Royalty Directive and the Savings Directive are both in place and the Code of Conduct has finished the work set out by the original mandate. What remains is a continuing mandate for monitoring standstill and rollback.

Undisputedly, a vast amount of work has been carried out by the Group since then. Furthermore, the members have learned a lot from the work carried out by the Group.

In the opinion of the Netherlands however, the instrument of political peer pressure has worn out. The Code may have changed the landscape of international taxation but it did not create a level playing field as was intended and the Netherlands do not see this happening in the future with the non statutory instrument of the Code of Conduct. The focus on national legislation has prevented us from taking necessary community actions. Being a political body the Group cannot guarantee equal treatment or consistency and therefore cannot guarantee a level playing field in the long run. The extension of the European Union to 25 member states further complicates the working of a political group. The Group is not an appropriate instrument to face the future challenges of the EU and to enhance the competitiveness of Europe. We have to do better.

Future

The remaining business of the Code of Conduct, monitoring stand still and rollback, hardly requires a High Level Group. In practice, most Member States already send delegates at a technical rather than at a political level. A subgroup or another group with technical experts, chaired by the Commission, would suffice for monitoring the standstill. Moreover, it should be noted that the most important instrument to tackle harmful tax measures remains the legal instrument of state aid.

A political group is required to prepare future steps[1]. The European Union will have to face up to economic reality, address the challenges of the Lisbon Agenda and ensure a level playing field in the long run. Instead of focusing on national measures, we should focus on a common approach. The most important message is that a structural approach should be based on legislation, not on soft law. For instance, work on promoting business start-ups, technology and innovation, mobile capital, reducing red tape and the reduction of state aids can contribute to the goal of enhancing the competitiveness of the EU.

Therefore, the Netherlands are of the opinion that future work should concentrate on establishing EU legislation on minimum standards to be applied. Soft law, like the instrument of the Code of Conduct, does not fit in this approach. Thus, the Netherlands see no future in extending the mandate of the Group, in neither time nor scope. The remaining work on monitoring standstill and rollback could be reassigned to a technical sub-group chaired by the Commission.

Poland

With reference to the request of providing written observation on the future of the Code of Conduct for Business Taxation, please let me express the following views:

Poland values highly the achievements of the Code of Conduct Group in the elimination of harmful tax practices in the European Union.

However, while structuring frames for future work in this respect the changed context since 1997 has to be born in mind. Poland is of the opinion that a legal instrument based on the minimum of common standards is the most appropriate instrument to address the issue.

[1] Some of the aspects of a political group were comprehensively discussed in the letter from the Presidency in April 2005 (Fisc 40/2005)

The designing and introducing tax measures belong to sensitive political issues. This sensitivity is even higher, when a measure has to be abolished, since the Group under the Code criteria assessed it harmful. That is why equal treatment of all Member States and consistency of the Group's decision are the primary concern of Poland. In this respect the problem of precedent needs to be addressed, if the Group continues its mandate. In order to guarantee the equal treatment we have to decide, whether in case the Member State invokes a measure that should have been considered harmful but in the past was accepted by the Group, such a measure has either to be used as a precedent or its assessment procedure has to be reopened.

Having in mind that the first is likely to jeopardise the credibility of the project, the aim of which is the elimination of harmful features of tax competition while the latter might lead to paralysis of the Group's work, Poland finds important to open discussion on establishing EU legislation on the minimum of common standards. The national tax system would be than assessed by the European Court of Justice, and not by the political Group.

In the case this solution is politically not feasible, new procedure governing the Group's work has to be established, in order to make work of the Group more effective. Also the criteria of assessment need to be re-examined. Moreover, it could be considered that some work on monitoring standstill and rollback measures could be done at technical level.

As far as extension of the Code beyond its current scope on other areas of taxation is concerned, Poland is not convinced that such changes should take place now. However, Poland is ready to consider extension of the work of the Group for undertaking action to combat tax avoidance and evasion under the existing scope of the Code.

Portugal

Portugal is the opinion that the Code of Conduct Group should continue its work on *standstill* and *rollback* process but some changes should be considered.

Procedural rules:

The evaluation made by the Commission of the new potential harmful measures introduced by the Member States and of the measures of rollback, should be sent to the MS at least **one month before the meetings** and should include all the relevant data and documents with the necessary detail to understand the context of the evaluation in order to give to the Member States the necessary time to make the assessment of the measures.

It would be useful that the Group agrees unanimously on what base the decisions should be taken: by unanimity or by great majority of MS and in this case to define "great majority".

It would also be useful to establish an agreement for the future that "a precedent decision" cannot be argued to evaluate a new potential harmful measure as «non harmful».

Future work:

News topics could be examined and discussed:

(i) The regimes applicable to expatriate qualified staff;

(ii) Exploring the possibilities of geographical extension of the Conduct Code (paragraph M of the Code);

(iii) Clarification the relations between the Conduct Code and the Treaty provisions on State Aids;

(iv) Measures that lead to double non-taxation.

Slovak Republic

Referred to request of providing written observations regarding the discussion on future of the Code of Condcuct Group we would like to notify:

The Slovak Republic appreciates the professional work carried out by the Group and its contribution to the process of elimination of harmful tax practices and to the support of fair tax competition within the EU.

It seems that number of potentially harmful tax measures implemented or drafted within the national legislations of the Member States has decreased and this could be considered as an effect of the achieving of the Group's aims.

The Group should continue in its present work regarding rollback and standstill and next meetings of the Group should take place in the case of sufficient number of potentially harmful tax measures and other relevant problems that could constitute the object of the discussion and of the assessment of the Member States.

Slovenia

With reference to the request of providing written observations on the future of the Code of Conduct for Business Taxation we would like to express the following views:

1. Slovenia appreciates the work that was done by the Group and supports the future of the Code and the Group. Since designing and introducing tax measures, and of course abolishing (potentially) harmful tax measures are complex and sensitive political issues the Group should be of a high level and the rules of procedure need to be discussed.
2. The criteria of the Code must respect differences in scales and openness of economies of the Member States. Therefore we propose exploration of that issue and revision of criteria 1b and 2b.
3. The Code should take into account Lisbon goals and should therefore support respective tax measures.
4. Slovenia is open to a debate on the extension of the scope of the work such as tax avoidance and evasion schemes, industries that have not been covered so far, etc.

Spain

In relation to the future work of the Code of Conduct Group, due to be discussed at forthcoming meetings of the Group, the Spanish delegation wishes to make the following comments:

1. PROCEDURAL QUESTIONS

With a number of years having passed since the establishment of the Group, certain procedural questions need to be discussed and changes may need to be made for the future:

(a) Adoption of decisions: In the absence of unanimity among members of the Group on a particular measure, it is not clear how the different views should be recorded in reports from the Code of Conduct Group to the ECOFIN Council (footnotes, specific references to the views of Member States, etc.). The procedure for such cases should be clarified.

(b) Minutes: In recent times the requirement to keep minutes of meetings has gradually been abandoned. We consider it important to have a chronological record of the discussions of a Group such as the Code of Conduct Group.

(c) Level of participants: Depending on the new issues which could be discussed by the Group, the question of whether to maintain the "high-level" nature of the group should be examined. Experience shows that, except where new issues are introduced for consideration under the Code and the decision on whether to examine such issues and the way this is to be done can have political implications, the Group has evolved over time into a technical rather than a political Group. We consider that the meeting at which the reports submitted to ECOFIN are approved should remain a high-level meeting; however, some of the other meetings that take place in the course of the year need not be high-level meetings.

(d) In line with the above comments, and depending on the content of the Code, the organisation of the Group (chair, secretariat, etc.) should be adapted to enable it to operate more efficiently. In any event, a general review of the procedural rules governing the Code should be undertaken.

Content:

(a) In relation to the possibility of incorporating new issues into the Code, the Spanish delegation considers that the exchange of information should be examined by the Code of Conduct Group in the future. In addition, and although it could be difficult in practice, transfer pricing is another area that could be investigated.

(b) In general, we consider that advantage should be taken of this opportunity for reflection to analyse certain important questions:

- Position of the Code of Conduct Group concerning State aid cases. Two good examples of the controversy caused by this issue are the recent Gibraltar and Malta cases. The difference between, and the implications of, the respective approaches in relation to a given tax regime should be clarified.
- The value of precedent and equality of treatment between Member States. Recent discussions have shown that a detailed analysis of this question should be undertaken.
- Revision of criteria: Practice has shown that the interpretation and application of some criteria should be revised. Moreover, in the light of that analysis, consideration could be given to incorporating new criteria.

(c) Lastly, consideration could be given to the way in which the criteria and work of the Code of Conduct Group could be extended beyond the geographical boundaries of the EU.

These comments are merely an introduction to the forthcoming debate, and each of the questions raised can be discussed in greater detail during the discussions.

Commission

Hereby the Commission services provide a contribution to the discussion on the 'Future of the Code of Conduct' upon the invitation of the Chair to submit written responses.

1. Introduction

Following a Commission proposal and discussion in the Taxation Policy Group, the Code of Conduct for business taxation was established by a resolution of the Ecofin Council on 1 December 1997[1]. The Code aims at eliminating harmful tax competition in the EU and the dependencies and overseas territories.

For political reasons the Code of Conduct for business taxation was included in the "tax package" which also included a Directive on savings[2] and a Directive for interest and royalty payments between associated companies[3]. This political aspect has played an important role in reaching results of the Group as agreed on adoption of the tax package on 3 June 2003. The results included rollback for 66 measures[4] which were considered harmful by the Code of Conduct Group. 'Rollback' in this context means the effective removal of harmful features of identified tax measures. After this result the Group proceeded with the monitoring of the rollback and 'standstill' which entails the obligation of Member States not to introduce new harmful measures.

The adoption of the tax package in June 2003 provided for a landmark in the Code of Conduct process. This was the first result for a full exercise from investigating, discussing, evaluating and accepting rollback commitments for harmful tax regimes. This means that the main part of the work has been done in reviewing existing harmful measures in Member States. Given this result, this contribution describes the implementation of the Code of Conduct for business taxation and reflects on the results achieved and possible conclusions to be drawn that could be of relevance for the future work to be done by the Group.

---

1 Conclusions of the ECOFIN Council meeting on 1 December 1997 concerning taxation policy, (OJ 98C 2/01)

2 Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments

3 Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States

4 In November 2003 a further 30 measures have been considered harmful by the Council in the Enlargement Process of the 10 new Member States.

This contribution will first of all, focus on the content of the Code, before going into the procedure and working of the Code Group. After the descriptive sections 2 (on content of the Code) and 3 (on the work of the Code), the results of the Group will be analyzed in section 4. In section 5 possible implications for future work of the Code will be presented.

2. Content of the Code of Conduct

As was mentioned before, the Code aims at eliminating harmful tax competition in the EU and the dependencies and overseas territories. To this end the Code includes a variety of criteria which should be used to determine whether or not a tax measure can be considered harmful. The first condition is whether a tax measures in the area of business taxation affects, or may affect, in a significant way the location of businesses. Furthermore, the measure must provide for a significantly lower effective level of taxation than those levels which generally apply in the State concerned. Such a lower level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor. If a measure is caught by these two conditions it is potentially harmful and covered by the Code.

In addition, paragraph B of the Code lists further conditions to assist in the assessment whether a measure is actually harmful or not. This non-exhaustive list has, in the vast majority of cases, been used to determine whether or not a measure is harmful. It should also be noted that the Group discussed and agreed on the practical applications of these conditions (e.g. the guidance notes on rollback and standstill – Ecofin Council of 26/27 November 2000).

The conditions listed in paragraph B are:
1. Whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents. In practice, account has also been taken of whether the measure was, in fact, targeted at non-residents, an indication of which could be found in the extensive practical use of such a measure by non-residents.

According to the standard practice of the Code of Conduct Group, criterion 1 (and 2) contains two alternative elements: the first element is whether the measure is only open for (criterion 1a) or in a majority of cases used by (criterion 1b) non-residents, i.e. permanent establishments of foreign companies or resident companies owned by foreign companies. This means that criterion 1a) concerns the *'de jure'* application of the measure. Criterion 1b) takes into account, where criterion 1a) considers the legal interpretation of the rules in question, the actual use of the measure by non-resident taxpayers (*'de facto'* application of the measure).

2. Whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base. In practice, account has been taken of whether the measure is clearly limited in its effect on the national tax base and the factual use of the measure.

In practice, the Code of Conduct Group also applied the a) de jure and b) de facto distinction to criterion 2. Furthermore, the application of criterion 2 has led to the interpretation that if all or a majority of beneficiaries are non-residents, the domestic tax base is (completely or partially) ring-fenced from the effects of the regime. Therefore, in principle, the evaluation against criterion 2 follows closely the evaluation of criterion 1.

3. Whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages. When assessing measures against this criterion account is to be taken of the nature and the scope of the activities in relation to the capital invested in, and the income derived from, them. Account should also be taken of the factual use of the measures.

4. Whether the rules for profit determination in respect of activities within a multinational Group of companies depart from internationally accepted principles, notably the rules agreed upon within the OECD. Account should be taken of the principles agreed in the OECD (1995) Transfer Pricing Guidelines and in the Model Tax Convention, without excluding the possibility of taking account of other sufficiently acknowledged internationally accepted principles.

5. Whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way. In practice, three factual tests have been applied as a starting point. If a measure is (1) fully set out in the legislation, or (2) in the form of regulations or guidelines, and (3) is not subject to any administrative discretion, it should be treated as transparent.

3. The work of the Code of Conduct Group

3.1. Set-up of the Code Group

In order to carry out the work set out in the Code of Conduct for business taxation, the Council set up a special high level Council Working Group ('the Code of Conduct Group') on 9 March 1998. In order to ensure consistency of the work it was decided that the Chair of the Group would be elected for a period of two years rather than change every six month with the change of the Council Presidency. The General Secretariat of the Council and the Commission Services were assigned to support the Chair. In practice this has meant that the Council Secretariat has contributed in procedural issues and the Commission Services on technical matters in the Code of Conduct Group.

3.2. First phase

The first part of the work for the Group was to identify the potentially harmful tax measures in Member States and in their associated and dependent territories. The identification process was based on an initial list provided by the Commission services, based on a peer review from Members of the Group, publicly available information and a study on administrative practices. All in all, the Group assessed close to 300 measures.

For all those measures the Commission services were asked to provide preliminary descriptions which were discussed and subsequently agreed by the Code Group. On the basis of the agreed descriptions the Commission services prepared draft assessments in association with the Chair of the Group on the basis of which the Code Group made its assessments. The Chair and the Commission services also provided the Code Group with generic and discussion papers on some of the more complex issues, such as the assessment of holding companies, regional measures, timing differences, and the fact that specific measures would target small and medium enterprises or take place in small economies.

3.3. 1999 Report

The work resulted in a Code Group report in November 1999, presented to the Ecofin Council, in which the Group concluded that 66 of the measures investigated had features that fulfilled the criteria of the Code and were therefore listed as harmful tax measures. It should be noted that according to the Group's rule of procedure[1], where unanimity was not possible, the Group worked on the basis of broad consensus and Member States that disagreed with the assessment of the Group could have their views reflected in the reports to the Council. This procedural rule has proved crucial in allowing the Group to agree on a report which could be presented to the Ministerial level.

3.4. Existing beneficiaries and new entrants

In the year following the November 1999 report work focussed on the technical discussion of rollback and led to a discussion between Member States on what deadlines would be applied. It was not until the ECOFIN meeting of 26-27 November 2000 that a political agreement on a review of the deadlines for rollback was reached. The deadlines agreed stated that all harmful measures should be rolled back by the end of 2002, that new entrants would be allowed until the end of 2001 (and in exceptional cases until the end of 2002) and that existing beneficiaries by the end of 2000 would be allowed to continue to benefit from a harmful scheme until the end of 2005 (transitional period). Furthermore, new entrants until the end of 2001 or 2002 were not allowed to benefit from the regime after the end of 2002. Finally, it was agreed that, on a case-by-case basis, the Council may decide to extend the effects of certain measures beyond 31 December 2005 on the basis of legitimate expectations or legal obligations at national or Community level in the context of rollback.

[1] ECOFIN Council conclusions, 9 March 1998, OJ 98/C 99/01

3.5. Taxation Policy Group

In the course of 2000 the Commission's Taxation Policy Group, as the initiator of the process of the Code of Conduct had a first discussion on a possible review of the Code of Conduct provisions. The discussion took into account several items which the Code of Conduct Group had encountered in its work, from nil or low levels of taxation, special tax incentives for expatriates and incentives for mutual funds and similar portfolio investment vehicles. Given the wide variety of opinions expressed in the Taxation Policy Group no firm conclusions could be drawn at that time. In 2003 Germany came back on this discussion and proposed in the Council to include the expatriate regimes into the scope and work of the Code. This suggestion was however not widely supported by the Member States.

3.6. Reaching agreement on rollback : 3 June 2003

The next step of the work for the Group was to determine whether or not the rollback proposals from Member States for the 66 measures were adequate, i.e. whether the harmful features of the measures were removed. In some cases this was achieved through the abolishment of the measure in question and in other cases through amendment of the harmful features of the existing measure. The technical work on both rollback and standstill was conducted by subgroups to the Code Group, chaired by the two vice-chairs (from the current and the coming Council Presidency). Although the deadline for the rollback was not completely met, adequate rollback was deemed to have taken place in almost all cases by the time the whole tax package was finally adopted in June 2003. However, it should be noted that the technical work on the rollback was finished well before the deadline of 31 December 2002 and it was events unrelated to this work that delayed the political agreement on the tax package.

As part of the rollback proposals, in certain cases Member States had made a request to the Council to allow existing beneficiaries to benefit from a regime beyond the end of 2005. Taking into account legal or other impediments, those requests were granted by the Council which means that some regimes will continue to have effects for existing beneficiaries until, in most cases, the end of 2010. In most cases, these transitional periods have been granted by the Council for beneficiaries that were already benefiting from the regime in 2001. However, there were also a few occasions where the benefits were implicitly or explicitly extended for beneficiaries entering as late as 2005.

3.7. Standstill

Apart from the work on rollback the Group has also monitored standstill, i.e. that Member States should refrain from introducing new measures that are harmful under the Code. In this respect Member States have annually reported to the Group whether they have introduced or are about to introduce new measures that could be considered potentially harmful under the Code. Notwithstanding some reluctance of Member States to willingly admit that their regime is potentially harmful, Member States generally speaking seem to have recognised the importance of getting their new schemes cleared under the Code. It therefore appears that most Member States have reported their new potentially harmful measures to the Group. In some cases information on new potentially harmful measures has come to the attention of the Group via publicly available information or through peer review. In the few cases where the Group has had some doubts, the Commission services has, together with the Member State concerned, produced detailed descriptions of the measure and, where necessary, a preliminary evaluation has been made of the regime. Where a new regime has been found harmful, the Member State concerned (or its dependent or associated territory) has made the necessary changes to the regime or refrained from introducing it.

3.8. Enlargement

As part of the accession process candidate countries at that time had committed to comply with the principles of the Code of Conduct. The screening in the context of the accession negotiations fell within the competence of the Commission and this resulted in a report drafted by the Commission services, in cooperation with the acceding states, listing potentially harmful measures in the acceding states. The report was presented to the Council Enlargement Group in 2003 which, in a special tax formation, proceeded with an assessment of the measures. The assessment of the Group broadly validated the assessment made by the Commission services. In its report to the Council the Enlargement Group concluded that 30 measures had features that fulfilled the criteria of the Code and were considered harmful. For 27 of the 30 harmful tax measures adequate rollback proposals had also been presented to either remove the harmful features or to abolish the harmful tax measure.

After the date of accession the work has been incorporated in the regular Code Group. The Group has taken over the monitoring of the rollback and the work on standstill for the new Member States. In those cases where adequate rollback has not yet been agreed discussions are ongoing in the Code Group.

3.9. Fiscal State Aid

When adopting the Code of Conduct it was recognised that some of the measures covered by the Code may also constitute state aid and several Member States asked the Commission to take action in this area. Therefore, in the light of the Code of Conduct (cf. paragraph J of the Code), the Commission undertook to publish guidelines on the application of State aid rules to measures relating to direct business taxation. The Commission also committed itself to the strict application of the state aid rules concerned. On 11 November 1998 the Commission adopted a notice on the application of the state aid rules to measures relating to direct business taxation. The notice forms part of the wider objective of clarifying and reinforcing the application of the state aid rules in order to reduce distortions of competition as they affect the single market and economic and monetary union. It should also be noted that the notice did not signal any change in the Commission's approach to assessing the compatibility of aid. It is based on case law from the Court of Justice and is designed to clarify how the state aid rules should be applied to business tax measures.

In performing its undertaking the Commission has given priority to measures which were also being examined under the Code and have a significant economic impact and particularly harmful effects on competition and trade. Where possible, the Commission has taken into account the outcome of the work of Code Group. However, it must be borne in mind that, although the two exercises are similar and pursue the same goal of reducing distortions of competition within the internal market they are not identical. The criteria are different for the two exercises and it is therefore quite possible for a measure to be found harmful under the Code but not constituting state aid and vice versa. Even though the two exercises have largely supported each other there have been instances where Member States have used one of the exercises to achieve a better result in the other process. For example, one Member State has used the results achieved under the state aid procedure to claim that no further rollback could be offered in the Code of Conduct Group, even though the rollback proposed was not falling within the time limits agreed in the Code Group. On the other hand, another Member State has used the Code of Conduct result in the Council to override an element of a state aid decision against one of its tax measures on the basis of Art. 88(2) of the Treaty.

The Commission has issued a follow up report on the application of the notice, "Report on the implementation of the Commission notice on the application of the State aid rules to measures relating to direct business taxation"[1]. The report concluded that the notice has been a suitable tool for assessing fiscal aid and that the case law on which it was based has confirmed its content. This has led to an increased awareness amongst Member States and companies operating within EU borders on the scope of Community rules.

Under the standstill procedure, the practice of the Code Group has been to wait for a state aid decision since Member States wanted to receive clearance from the Commission first before introducing a new tax regime and in a number of cases this resulted in a swift clearance of the regime in the Group.

3.10. Current work of the Group

After the adoption of the tax package the Group has been monitoring the rollback commitments and standstill. In this respect all Member States provide information to the Group on the implementation of the rollback commitments and on potentially harmful tax regimes which are brought forward under the standstill obligation. Under the standstill procedure some interesting cases are being discussed on the relevant developments in the tax systems of the Member States.

4. Assessment of the Code of Conduct results

4.1. Success

The adoption of the tax package and the present final stages of the monitoring of the rollback seem to provide a good opportunity to take a step back and evaluate the Code of Conduct on its results.

[1] C(2004)434

It is generally considered that the work conducted under the Code has been successful. It has at times been difficult and delicate but it has in effect led to the dismantling of the most harmful tax measures in Member States and their dependent or associated territories. In this respect Member States might consider that the application of the Code, in general, has led to more transparency, co-operation and fair tax competition within the EU. Furthermore, the Code results can, in principle, be considered as part of the EU acquis which can not be disregarded by future EU members or by third countries in their relations with EU Member States.

The intention of the Code was not to end all tax competition but only tax measures that were identified as harmful tax competition in the meaning of the Code. The progress in Member States since the Code was introduced also shows that Member States now are competing more with general measures, such as lower general rates which benefit all businesses. Even though this could be considered as a fair result, there have been some developments, especially in some dependent and associated territories where the rollback proposed included the introduction of a 0% rate or the complete abolition of corporate income tax.

Considering the above, the work done under the Code has led to good results but one could argue that not every part of the work has resulted in a consistent or satisfactory outcome.

4.2. Compromises leading to lack of peer pressure

Although the three different elements of the tax package were linked from the beginning, the timetables were not. In accordance with the Feira European Council, the ECOFIN Council of 10 July 2001 approved a parallel timetable for work on the various components of the tax package. This has at times slowed down the process and meant that the work has lost momentum.

At times the work has suffered from being a non-statutory instrument which has given too much room for compromises at certain stages. In this respect it should be noted that the 1999 report was never agreed upon by the Council at that time which, looking back, was not really in the spirit of the Code process. With the benefit of hindsight it seems that due to political compromises the Group has considered some rollback proposals adequate, which could easily be considered as insufficient according to the principles of the Code. The political aspect of the Code has in some cases played a positive role and provided momentum for the work. However, in some cases where Member States had not presented an acceptable rollback just before the agreement on the tax package, the negotiation aspect meant that there was little or no peer pressure from other Member States in order to make them comply with the Code.

The aspects mentioned above have led to two forms of rollback which one might consider to be inadequate.

4.2.1. Remaining harmful features

First, some regimes have been approved, after amending proposals, which still include features that could easily have been considered as harmful by the Group, or that still open opportunities to tax planning schemes. The fact that the Group has allowed that harmful features were continued in tax regimes has led to the creation of "benchmarks". In reality it means that Member States having to make changes to their existing measures because they are found harmful or Member States designing a new measure tend to take the lowest level accepted by the Code Group for the different features of the measure.

4.2.2. No timely rollback: new entrants allowed

Secondly, some rollback proposals were not in line with the timeframe agreed for rollback. This meant that three regimes will continue to allow new entrants in or after 2005. It is therefore even more regrettable that the conclusions from the Ecofin Council meetings have become increasingly vague in its demands on results from the Code Group. In the report from the Code Group to the Council of 7 June 2005, for example, it was explicitly stated that in one case the Member State concerned had failed to implement the rollback as agreed. Despite this clear non-compliance the Council failed to take any action. So the Member State concerned was not politically challenged or urged to comply with the Code principles and agreements. In this respect also two other Member States did not fulfil their commitments for a timely rollback according to the Code commitments and allowed new entrants after an agreed deadline.

4.2.3. Transitional periods for existing beneficiaries

On the basis of the November 2000 agreement (as mentioned in section 3.4.) some Member States argued that existing beneficiaries of their (harmful) regimes had to be allowed an even longer transitional period than the end of 2005. They requested and received from the Council an extension of benefits for, in general, five more years (i.e. until the end of 2010), and in some cases even beyond 2010. Despite the fact that these extensions were granted only for a limited number of regimes, for a limited number of beneficiaries and for a limited timeframe it is still unsatisfactory that some clearly harmful tax measures are allowed to have effects after the "final" deadline, especially since not all requests were based on legitimate expectations or legal obligations at national or Community level as was set out in the November 2000 Ecofin Council.

4.3. Sectors excluded

In principle, the Code of Conduct should cover all business activities. However, in the discussions prior to the November 1999 report it was decided (cf. paragraphs 61 and 62 in the report) that regimes favouring the shipping sector, because of the fierce global competition, had to be given special treatment and actually none of them were found harmful under the criterion of the Code. Although the Commission recognises the importance of a competitive EU shipping business the argument about "fierce global competition" can be used on many other sectors today and should not have resulted in the (more or less) exclusion of a whole sector from the assessment of harmfulness under the Code of Conduct.

Apart from shipping, the Group also agreed in 1999 to leave out, for the time being, the assessment of collective investment vehicles and to refer the point of principle to the Taxation Policy Group. In 2000 the Taxation Policy Group discussed the matter briefly, unfortunately without any progress.

4.4. Third countries

Another issue which should be considered is the geographical extension of the Code. Already in the discussions leading up to the Code, and as clearly reflected in the Code itself (paragraph M), it was recognised that in order for the fight against harmful tax competition to be effective it has to apply on as broad a geographical basis as possible. In this respect Member States that have dependent or associated territories committed themselves, within the framework of their constitutional arrangements, to ensure that the principles of the Code also applied to those territories. Although all Member States also committed themselves to promoting the Code principles to third countries as well, so far no significant results have been achieved. The efforts of the OECD in this respect started with the same objectives, however, since the criterion of ring-fencing has been taken out of the OECD exercise, insofar as tax havens are concerned, it is not as close to the EU initiative as it used to be anymore.

5. Potential implications for the future?

Considering all of the above one could argue that several items can be considered to have potential implications for the future and could to be taken forward. The potential implications mentioned below are by no means meant to be exhaustive. All of the aspects mentioned could lead to complex and difficult exercises on a technical level as well as on a political level. Therefore the paragraphs below are meant to provide for some initial points of reflection which could be discussed in order to exchange views on the implementation of the Code and the potential implications for the future.

5.1. Monitoring of the rollback and standstill

As mentioned before, after the adoption of the tax package the Group has been monitoring the rollback commitments and standstill. The Group nowadays usually meets approximately four times a year and provides progress reports to the Ecofin Council twice a year. In this respect it should be noted that eventually the monitoring of rollback will fade out since the proposed amendments will have been enacted before a certain date (most of them before the end of 2005), but the element of standstill is an ongoing process which should be followed on a regular basis in future. On the format of the work on standstill, paragraph 5.6. will elaborate on the possible set-up of the Group. However, whatever set-up will in the end be chosen by the Council, it is crucial to ensure a lasting and effective functioning of the standstill provision and the question for the Member States would be to determine a format and procedure for this work.

5.2. Building on positive achievements

Considerable work has been undertaken by assessing almost 400 tax measures throughout the EU, and achievements have shown that best practices are possible. In order to build on the results achieved, Member States could consider confirming the principles on which they agreed by developing guidance notes or 'best practices', comparable to the OECD application notes[1].

Secondly, some concerns have been expressed that zero rates, or abolition of the corporate income tax, which have been offered as rollback can hardly be seen as a satisfactory result for the Group, as such solutions may still affect significantly the location of businesses within the Community. This element could be discussed further. The same applies for the collective investment vehicles.

Another area where the Code Group already has done substantial work is information exchange in the area of transfer pricing. This work resulted in Member States agreeing in 2003 on an exchange of information in the area of transfer pricing on individual cases which should then be reviewed on a regular basis in the future. Unfortunately, no effort has been made so far to assess the practical functioning of this agreement. The Member States could perhaps reflect on the question whether and in what form a review of the functioning of this exchange of information can be done.

[1] Consolidated application note: guidance in applying the 1998 report to preferential tax regimes (OECD, 2003)

5.3. New measures under the Code

On the basis of developments of tax systems within EU Member States one could consider the need for widening the scope of the measures covered by the work of the Code. According to the initial assessment of the Commission services, in the possible new areas proposed below, one could argue that it would perhaps not be necessary to actually change the Code or the mandate to the Code Group.

Already during the discussions concerning the drafting of the Code of Conduct, Member States have pleaded for a wider scope than finally decided. This is also reflected in the preamble of the Code where the Council recalled that certain Member States and the Commission considered that special tax arrangements for employees ("expatriate regimes") could come within the range of the problems covered by the Code. The Commission is still of the opinion that some of these arrangements may constitute harmful tax competition and would therefore like to see them evaluated. Furthermore, in May 2000 the question of an extension of the Code was discussed in the Taxation Policy Group. At that time it was agreed that the Code Group should first finish its ongoing work before making any changes in the work. Several Member States again expressed the opinion that the Code work in the future should cover more issues, including expatriate regimes.

There were, however, divergent views on whether the regimes were already covered by the Code or not. In the view of the Commission services it could be argued that most expatriate regimes would be covered by the existing Code as it is not limited to corporate taxation but covers business taxation which is a wider concept and should cover all taxes that affect, or may affect, in a significant way the location of business activity in the Community.

A similar discussion concerning the coverage of the Code has arisen from the fact that at least one (new) Member States has resorted to providing the tax benefits of a preferential regime at the (corporate) shareholder level (by refunding corporation taxes) arguing that such a regime was not covered by the Code. So far, the majority of Member States nevertheless considered the measure in question to be covered by the Code. However, it cannot be excluded that there will be further attempts to design tax measures that are harmful within the spirit of the Code while being arguably outside the literal scope of the Code. This could significantly weaken the effectiveness of the Code of Conduct.

Apart from these measures there may be other measures which, either because they were not covered by the scope of the Code or because they were not identified as problematic at the time, were not subject to an evaluation by the Group but in fact may constitute harmful tax measures. One such area is the use of different forms of hybrids and the effect that can be achieved by abusing the differences in treatment that exists in different tax systems. This can be achieved by using hybrid entities, i.e. entities which are considered as a corporate body (opaque) by one Member State and as non-corporate (transparent) by another Member State; this difference in qualification by Member States creates possibilities for double exemptions or double deductions. It can also be achieved by the use of hybrid capital, e.g. the difference of qualification by Member States of debt / equity; one Member State considers a certain loan (without a market interest rate or repayment plan) as equity and therefore does not include the interest received by a group company as income whereas another Member State does consider the loan as debt and allows the (deemed) interest paid as a deduction for the group company paying the interest. This could result in a deduction in one Member State and an exemption in another Member State.

Of course, differences in tax systems in different Member States can lead to both double non-taxation and double taxation without anybody being to blame. It is just the unfortunate result of dealing with different systems. However, in cases where one Member State actively promotes tax planning schemes based on those differences or even introduces legislation to create such a difference it can be argued that this is no longer a case of unfortunate consequences and the Member State concerned should be requested to change the practice or legislation. Arguably this is not an area where the Code Group has done work before. Furthermore, one could also argue that the Code does not have to be amended to cover these regimes. It should be pointed out that looking into these regimes would require a fair amount of preparatory work and it would possibly be necessary to commission an independent study.

Furthermore, there may even be cases where the measures were examined by the Group but where it would be useful to have a new look. One example could be the administrative practices. There may be new forms to look at (especially since new or amended administrative practices would be unlikely to be notified under the standstill procedure). There are indications that some Member States have reverted to issuing potentially harmful rulings (not in accordance to OECD transfer pricing guidelines) to certain taxpayers but work in this area is complicated and it is difficult to get the necessary information (usually that information is provided by a taxpayer who did not get such a ruling or has his business affected by someone who has). However, as this is more or less the essence of harmful tax practices, an indication that it is still ongoing should be investigated even if it probably would require commissioning a study from the outside.

5.4. Review of the Code criteria

On the basis of the experience from the past with the Code criteria, mentioned in section 2, one could also consider to review the criteria used and perhaps sharpen the tools with which tax regimes are evaluated, notably in order to better reflect the practice of the Group in the Code criteria. In this respect one could, for example, take into account the practical application that the Group has given to criteria 1 and 2 of the Code, as mentioned in section 2, where the Conduct Group applied a 'de jure' and 'de facto' approach.

On the other hand, tax systems in the Member States have evolved since 1997 and Member States could perhaps investigate other criteria which should be taken on board to evaluate tax measures which have not been considered up to now (e.g. hybrid structures).

5.5. Geographical extension of the Code

In order to avoid that the successful work under the Code only leads to companies establishing themselves outside the EU (and the dependent and associated territories) the Commission and the Member States must make sure that the principles of the Code are promoted elsewhere as stipulated by paragraph M of the Code. This can be done in negotiations of different agreements, partnerships or treaties or when deciding on development policies as described in the recent Communication from the Commission on Preventing and Combating Financial and Corporate Malpractice (COM (2004) 611). It is of great importance that both the Commission and Member States are seen as having a coherent approach in this regard. In this respect it can be mentioned that the Commission, as part of the European Neighbourhood Policy (ENP), successfully negotiated the inclusion of a reference to the principles of the Code of Conduct in the Action Plans for Israel, Jordan, Morocco, Moldova, Tunisia and Ukraine, which have been adopted by the Council. The Action Plans are tools for economic and political co-operation between the EU and the partner countries, carrying to a further stage the commitments and objectives contained in the Partnership and Cooperation Agreements. The implementation of the Action Plans aims amongst others at significantly advancing the approximation of these countries' legislation, norms and standards to those of the European Union. In future, the Commission will continue to promote to include the reference to the Code principles in further agreements with third countries.

5.6. Set-up and procedure of the Group

The Group was set up as a high-level Group and for the first couple of years when the Group was preparing the list of harmful measures and discussing the rollback proposals it was necessary to have a political high level of the participants. However, during the last couple of years, as the work has focussed on monitoring the rollback and standstill, the need for a high level participation from the Member States has become less obvious. It is therefore clear that with the current work of the Group it is no longer necessary to have a high level Group. In this case the work on standstill could probably be done by a subgroup or another group with representatives with technical expertise.

However if the Member States would decide to include some or all of the other elements, mentioned in section 5, in the future work of the Group, it could be recommendable to maintain the high level format which has been used so far. In this case it might also be worthwhile to discuss the rules of procedure of the Group.

6. Conclusion

Looking back at the past, the Commission services consider that the work done in relation to the Code of Conduct, aiming at tackling a specific type of harmful tax competition in the European Union, and initiated by the Commission at the informal meeting of Ministers for Economic Affairs and Finance in Verona in April 1996, has led to significant results for the taxation landscape within the EU. In this respect, one could argue, that the dismantling of harmful tax measures has led to a significant reduction of distortions in the single market. The Commission services also welcomes the fact that the application of the Code, in general, has led to more transparency, co-operation and fair tax competition within the EU.

Given the positive results of this exercise the Commission services would like to suggest to the Member States the following approach for the future of the Code of Conduct.

- The aim of monitoring standstill should be upheld since this is crucial for the work that has been done so far.

- Member States should be invited to reflect on the possibility to build further on the results achieved in the past; this includes the possible development of best practices and the review of the exchange of information agreement.

- Member States could consider to investigate other tax measures under the scope of the Code of Conduct in the light of new forms of harmful tax competition.

- Member States could consider to reflect on a review of the Code of Conduct itself and the procedures of the Group.

- Member States could reflect on further efforts to promote the adoption of the principles of the Code of Conduct on as broad a geographical basis as possible as foreseen in paragraph M of the Code.

- Member States could also reflect on the handling of non-compliance with the Code of Conduct and decisions of the Group.

All these elements could help improve the fight against harmful tax competition, in which ever form, which affects, or may affect, in a significant way the location of business activity in the Community.

_____

Note: The comments listed in this Annex are those received before 3 February 2006.