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**REPORT**

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to:	Council (ECOFIN)
on:	7 December 2010
Subject:	Code of Conduct (Business Taxation)
	- Report to the Council (ECOFIN)

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**INTRODUCTION**

1. On 1 December 1997, the Council and the Representatives of the Governments of the Member States, meeting within the Council, adopted a Resolution on a Code of Conduct for business taxation. This Resolution provides for the establishment of a Group within the framework of the Council to assess tax measures that may fall within the Code. In its report to the Feira European Council on 19 and 20 June 2000, the ECOFIN Council agreed that work should be pursued with a view to reaching agreement on the tax package as a whole, according to a parallel timetable for the key parts of the tax package (taxation of savings, Code of Conduct (business taxation) and interest and royalties).

2. On 9 March 1998, the Council confirmed the establishment of the Code of Conduct Group. The Group reported regularly on the measures assessed and these reports have been forwarded to the Council for deliberation.
3. Two interim reports of the Code of Conduct Group were presented to the ECOFIN Council on 1 December 1998 and 25 May 1999 respectively (12530/98 FISC 164 and 8231/99 FISC 119). Subsequently, the Group reported to ECOFIN on 25 November 1999 setting out the results of the Group's work (SN 4901/99) on the assessment of 271 tax measures under the Code where the Group considered 66 measures harmful.
4. On 13 October 2003, the Council welcomed a report by the Working Party on Enlargement (Tax Experts) (13213/03 ELARG 94 FISC 138) establishing a list of 30 measures found harmful under the Code in the Member States that acceded on 1 May 2004. The Council also agreed on the adequacy of the rollback measures envisaged or already undertaken for 27 of these measures.
5. On 11 July 2006, the Council took note of a report by the Working Party on Enlargement (10879/06 ELARG 66 FISC 96) establishing a list of 8 measures found harmful under the Code in the two Member States (Bulgaria and Romania), which acceded on 1 January 2007.
6. This report from the Code Group encompasses the work of the Code Group in 2010 under the Belgian Presidency.
7. In accordance with the Procedural Aspects of the Group (16410/08 FISC 174), the Group should maintain to aim at a (broad) consensus to reflect the positions of the Member States in the Group in its reports to ECOFIN, to avoid loosing the effectiveness of the Group, while respecting the principle of unanimity as laid down in the Council conclusions of 9 March 1998 concerning the establishment of the Code Group. In the case broad consensus cannot be reached, the Group's reports can express the various views mentioned.

## **PROGRESS OF WORK**

8. The Code of Conduct Group met on 23 September and 19 November 2010 under the Belgian Presidency.
9. At the meeting of 23 September the Group also confirmed a programme of work under the Belgian Presidency, agreeing to take forward work in the following areas:
  - (a) to continue its work on standstill;
  - (b) to continue its work on the following not finished items of the Group's Work Package:
    - Anti-abuse: inbound profit transfers and profit participating loans;
    - Administrative practices: identification of harmful rulings and improvement of the exchange of information for cross border rulings;
    - Links to third countries: continuation of discussions.

### *Appointment of Vice-Chairs*

10. Mr Jacques Gombeer (Inspector General in the Ministry of Finance of Belgium) and Mr Ádám Balog (Deputy State Secretary in the Ministry for National Economy of Hungary) were confirmed as the first and the second Vice-Chairs for the period up to the end of the Belgian Presidency.

## Standstill

11. Member States have made commitments not to introduce new tax measures that would be harmful within the meaning of the Code. The Group's work programme for the Belgian Presidency identified the following measures where further discussion under standstill was required:

- *UK: Jersey – Zero-Ten Corporate Tax Regime;*
- *UK: Isle of Man - New Tax Legislation;*
- *Hungary: Tax Base for Interest Payments Received from Abroad.*

Furthermore, the programme indicated that other developments in the area of standstill might need to be addressed (Paragraphs 23 - 25 of doc. 10033/10 FISC 47).

12. As regards UK: Jersey – Zero-Ten Corporate Tax Regime and UK: Isle of Man - New Tax Legislation, in its meeting on 23 September the Group was presented with the agreed descriptions of these measures. After discussion on the descriptions and an exchange of views with those concerned, the Group invited the Commission to prepare draft evaluations. The Group discussed these draft evaluations in its meeting on 19 November. The Group agreed that the measures give rise to harmful effects. The Group recommends that the Council reviews this on the basis of the conclusions of the Council High Level Working Party's work as outlined in Paragraph 24.

13. As regards the Hungarian measure, in its meeting on 23 September the Group discussed the agreed description of this measures and decided to invite the Commission to prepare draft evaluation. The Group discussed the measure in its meeting on 19 November. Hungary announced that the measure will be abolished as from 1 January 2011, without any transitional provisions, and agreed to provide the Group with the details of the relevant legislation for the Group's consideration in its next meeting.
14. In addition to that, during the meeting of 23 September the Luxembourg measure (Group Financing Companies - Advance Confirmation of Margins) was notified to the Group. The Group agreed that an agreed description of this measure was necessary. In the meeting of 19 November the Commission informed the Group that it had not yet been possible to agree on a description with the Luxembourg delegation, due to ongoing changes in the relevant provisions. The Group agreed to come back to this matter in its next meeting.
15. In its meeting on 19 November the Group had an exchange of views on other developments in the area of standstill (Paragraphs 23 - 25 of doc. 10033/10 FISC 47). With respect to the Slovenian measures (Tax relief Pomurje region and Amendments to the Economic Zones Act) and the changes in the legislation of Cyprus regarding taxation of interest and the participation exemption, the Group agreed that there was no need to pursue these matters further.

## Work Package

### Anti-abuse

16. Regarding **Inbound Profit Transfers**, the Group agreed that a risk of abuse arises regarding profits entering the EU from non EU countries, whether directly to the Member State of receipt (being the Member State in which the ultimate parent company is resident) or through several Member States up to the Member State of receipt, when such income has not been taxed or it has been subject to tax at source at a low tax rate. There is a risk of abuse in this case, since the subsidiary resident in a third country will be able to avoid inbound taxation by using the most convenient Double Taxation Agreement (DTA). That income will afterwards freely flow within the EU with no withholding tax (subject to the rules of the Parent-Subsidiary Directive), arriving untaxed at final destination.

On this issue the Group, noting the guidance on Rollback and Standstill contained in the Code Group's Report to ECOFIN Council on 26-27 November 2000, was able to agree the following guidance:

*Member States may opt to tax inbound profit transfers or to operate a participation exemption. Member States which operate a participation exemption should either ensure that the profits which give rise to foreign source dividends are subject to effective anti-abuse or countermeasures, or apply switch-over provisions targeted at ensuring effective taxation. The first could be achieved through a Member State having CFC-legislation or other anti-abuse provisions which ensure that profits artificially diverted from that Member State which may give rise to foreign source dividends are appropriately taxed.*

17. **DELETED**

#### Administrative practices

18. Continuing the work undertaken under the Swedish Presidency (doc. 16233/09 FISC 163) and under the Spanish Presidency (doc. 10033/10 FISC 47), the Group discussed the issue of administrative practices at its meetings on 23 September 2010 and 19 November 2010 concentrating in particular on two issues:

- Defining and identifying harmful rulings, with a view to being able to better distinguish general administrative practices of granting advance clearance from harmful rulings, and

- Improving exchange of information for cross border rulings - broader exchange of relevant information on rulings that may affect tax bases of other Member States.

19. Rulings concern the advance interpretation or application of tax provisions by the tax administration to a specific fact pattern of a specific taxpayer. With respect to the identification of harmful rulings the Group agreed the following guidance:

- *In order to start a review process with respect to administrative practices, MSs are invited to share with the Group their knowledge or suspicion about harmful administrative practices of other MSs.*
- *The criteria for assessing the harmfulness of an administrative practice are the five criteria for harmfulness as laid down in Paragraph B of the Code of Conduct.*

20. The Group recalled that with respect to improvements in the field of transparency it has already agreed the following guidance:

- *To the extent that a MS accommodates the advance interpretation or application of a legal provision to a specific situation or transaction of an individual taxpayer, the underlying procedures should be embedded in a transparent legal and administrative framework, that is public legislation or administrative guidelines.*
- *Where the advance interpretation or application of a legal provision to a specific situation or transaction of an individual taxpayer is suitable for horizontal application in similar situations, this interpretation or application should be published or be reflected in updated guidance, or be made otherwise publicly available.*



21. With respect to improving exchange of information for cross border rulings, the Group agreed the following:

- *If a Member State provides advance interpretation or application of a legal provision for a cross border situation or transaction of an individual taxpayer (hereafter: cross border ruling), which is likely to be relevant for the tax authorities of another Member State, the tax authorities of the first Member State will spontaneously exchange the relevant information regarding this cross border ruling in accordance with the provisions of the Directive on Mutual Assistance with the latter Member State in order to assure coherent overall taxation.*
- *By means of a non-exhaustive list, this would specifically concern the following types of cross border rulings:*
  - o MS 1 gives clearance on the absence of a PE in MS 1 to a company resident in MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).*
  - o MS 1 gives clearance on specific items related to the tax base of a PE in MS 1 to a company resident in MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).*
  - o MS 1 gives clearance on the tax status of a hybrid entity resident in MS 1 which is controlled by residents of MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).*
  - o MS 1 gives clearance to a company resident in MS 1 regarding the tax value for depreciation for an asset that is acquired from a group company in MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).*

### Links to third Countries

22. In order to facilitate the work of the Group in promotion of adoption of the principles of the Code of Conduct in third countries, on 8 June 2010 the Council invited the Commission to start a dialogue with Liechtenstein and Switzerland on the application of the principles and criteria of the Code, and to report back to it before the end of the Belgian Presidency (doc. 10595/10 FISC 57).
23. On 19 November 2010, the Commission informed the Group about the exploratory meetings it had with Switzerland and Liechtenstein. The Group encouraged the Commission to continue discussions and to keep the Group regularly informed of the progress.

### **FUTURE WORK**

24. The Group recommended the Council to task the Council High Level Working Party for tax issues to examine the scope of the Code.

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