

ROOM DOCUMENT # 3
Code of Conduct Group (Business Taxation)
20 March 2013
ORIGIN: Commission

WORKPACKAGE 2011 – MONITORING GUIDANCE ON INBOUND PROFITS

Background

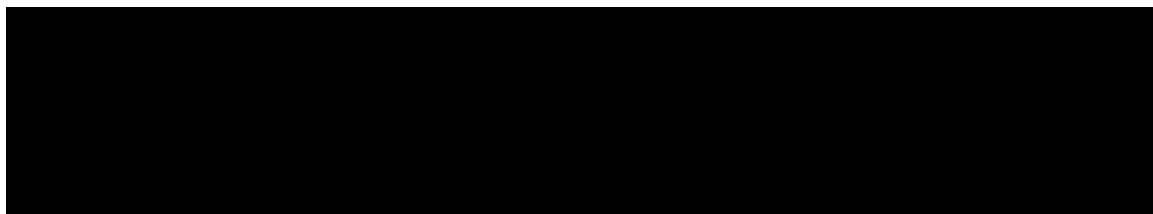
1. Following the adoption of the Code Group's Work Package 2011 on 19 December 2011 (doc. 17081/1/11 REV 1 FISC 144), at its meeting of 7 February 2012, the Code Group decided that the monitoring of the implementation of guidance notes previously agreed by the Group would begin with the guidance on inbound profit transfers.

2. The guidance says;

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.¹

Therefore if a MS grants a participation exemption the guidance requires it to apply either effective anti-abuse rules (e.g. CFC rules) or a switch over provision. A switch over provision is one that applies in particular circumstances to provide relief for double taxation via the credit method rather than exemption. The assessment of any Member State's rules against the guidance is therefore a question of what constitutes an effective anti-abuse or switch over provision.

3. To help with the monitoring exercise a questionnaire for Member States was agreed at the meeting of 17 April 2012. A consolidated version of MS replies was initially circulated to Group members for the meeting of 4 June 2012. A revised version of the replies together with a summary table was circulated with room document 2 of 10 September 2012. The same room document provided an analysis of MS replies against the agreed guidance.



¹ Code Group Report of 22 November 2010, doc. 16766/10 FISC 139, par. 16.

- [REDACTED]
- [REDACTED]
- [REDACTED]

Agreeing the basis on which to apply the guidance

- [REDACTED]
- [REDACTED]
- [REDACTED]

Controlled foreign company rules

- [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Switch over rules

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

- Do MS think that this paper makes the distinction between the toolbox and minimum standard approaches clear?
- What additions would MS like to make to the tables in either columns A or B?
- Do MS think that the minimum standard and toolbox approaches could be combined, for example if column A set out the minimum standards and column B provided the tool box?

Annex 1**Table A – elements of effective anti-abuse provisions: controlled foreign companies**

	A		B
1	Definition of a CFC	a	Company not resident in MS
		b	Company controlled directly or indirectly by MS Company
		c	Control to be determined by ownership of more than a specified percentage of the CFC's share capital and/or voting rights
		d	Control to be determined by rights to receive more a specified percentage of the CFC's profits regardless of legal form of the shareholding
2	Definition of the persons on whom CFC tax ¹ will be charged	a	Limit charge to CFCs ultimately controlled by nationals of MS
		b	Charge resident companies in respect of their foreign subsidiaries
3	Method of accurately calculating the CFC's tax base	a	Calculate tax base by reference to international standards (e.g. IAS, OECD)
		b	Calculate tax base using the rules applied to companies resident in MS
		c	Calculate tax base using the rules applied to companies in the LS with any necessary adjustments to remove divergence from international standards (e.g. application of arm's length principle)

¹ See list of definitions on page 8.

	A		B
4	Distinguish between active and passive income	a	Target the regime specifically at passive income
		b	Target the regime broadly but provide exemptions for active income
5	Apply only to territories with a lower level of tax	a	Define a lower level of tax in relative terms as a specified percentage of the MS' own tax rate
		b	Define a lower level of tax in relative terms as a percentage of some other figure such as the average rate in the EU
		c	Define a lower level of tax in absolute terms as a fixed percentage
		d	Base the definition of a lower level of tax in a, b or c on the local tax actually paid
		e	Base the definition of a lower level of tax in a, b or c on the headline rate
6	Contain other territorial exclusions	a	Exclusion for members of the EEA/EU
		b	Exclusion for members of the OECD
		c	Exclusion for members with which the MS has a double taxation agreement including particular articles (e.g. exchange of information or non-discrimination articles)

	A		B
7	Counter-act the artificial diversion of profits	a	Charge CFC tax to bring the local tax rate up to the MS tax rate
		b	Allow double taxation relief for local tax
		c	Allow relief for CFC tax paid when profits subsequently distributed

Definitions used in the table

CFC tax	<i>tax chargeable on MS Co in respect of the profits of the CFC</i>
LS	<i>the CFC's territory of residence, the local state</i>
Local tax	<i>tax paid by the CFC in its territory of residence</i>
MS	<i>the Member State applying the CFC rules</i>
MS Co	<i>the company resident in MS which controls the CFC</i>

Annex 2**Table B – elements of effective anti-abuse provisions: switch over rules**

	A		B
1	Apply only to dividends from territories with a lower level of tax	a	Define a lower level of tax in relative terms as a percentage of some other figure such as the average rate in the EU
		b	Define a lower level of tax in absolute terms as a fixed percentage
		c	Base the definition of a lower level of tax on the local tax actually paid rather than headline rates (e.g. to remove the effect of special regimes)
		d	Base the definition of a lower level of tax in a, b or c on the local tax actually paid
		e	Base the definition of a lower level of tax in a, b or c on the headline rate
2	Contain territorial exclusions	a	Exclusion for members of the EEA/EU
		b	Exclusion for members of the OECD
		c	Exclusion for members with which the MS has a double taxation agreement including particular articles (e.g. exchange of information or non-discrimination articles)
3	Provisions to restrict abuse	a	Exclusion from exemption for particular types of dividends
		b	Exclusion from exemption for dividends connected to abusive transactions

Annex 3

Extract from room document 2 of 10 September 2012

[...]

2.3 Elements in assessing effectiveness of anti-abuse measures

As set out above, most MS have established one or more qualitative criteria, either as a condition to grant full exemption for inbound dividends or to establish situations in which their CFC provisions or other anti-abuse measures kick-in. All MS that have established these qualitative criteria have their own policy in that respect, using one or more of the criteria and giving more or less weight to each of them. COM realises that establishing common ground in this area is an ambitious task in view of the different policies pursued by the MS. Nevertheless, it may be useful for the Group to discuss in more detail the benefits and disadvantages of these criteria for potential further guidance³.

a) Relevance of the subsidiary being a resident of the EU / EEA

Some MS do not set any qualitative conditions if the subsidiary is located in an EU or EEA State or if the conditions of the PS Directive apply. This could be considered acceptable in view of the need to comply with the EU legal framework and given the fact that EU and EEA States are subject to certain minimum standards (e.g. State Aid; within the EU also the Code of Conduct).

b) Relevance of the subsidiary being a resident of a DTC country

Some MS do not set any qualitative conditions if the subsidiary is located in a State with which they have a DTC, in some cases this must concern a qualified DTC (containing a provision on EoI). In COM's view, it could be questioned whether the presence of a (qualified) DTC is sufficient not to set any further conditions. Bilateral treaty partners do not have to meet the same legal obligations as EU / EEA States. Some MS may have concluded or want to conclude a DTC with a third country that other MS would not conclude a DTC with. If the Group were to accept the presence of a DTC as sufficient for not setting any further qualitative conditions, the Group may want to consider the usefulness of more coordination of MS's DTC policy, e.g. by setting minimum standards.

c) Relevance of a minimum statutory tax rate for 3rd countries

For subsidiaries resident of a 3rd country some MS require that minimum criteria concerning the corporate tax rate in that 3rd country are met. In some cases this concerns an absolute minimum level (e.g. 10% or more) but in most cases the minimum level is linked to the applicable domestic corporate tax rate (e.g. minimum half of the domestic rate or "comparable" to the domestic rate). The Group could agree that a minimum tax rate requirement should be set, with the minimum to be determined by the MS in question.

³ Art. 73 of the CCCTB Directive proposes a switch-over if the entity making the profit distribution is subject, in its country of residence to a tax on profits, under the general 82, see footnote 5).

Alternatively, the Group could also consider more coordination in this respect, which would effectively require agreement on a common minimum tax rate vis-à-vis 3rd country dividends (see also footnote 3).

d) Formulating the minimum tax criterion

As explained under c) above, some MS set minimum tax rate conditions for the jurisdiction of which the subsidiary is a resident.

Some MS apply these conditions to the subsidiary itself rather than to the jurisdiction (the subsidiary must be subject to a corporate tax with a rate of at least x%). Finally, some MS place conditions upon the effective tax burden of the subsidiary, requesting the profits of the subsidiary to be subject to a minimum effective corporate tax rate of y%. The last requirement is the most specific and therefore also most effective. The Group could consider developing recommendations in this area.

e) Relevance of foreign tax base

Not only the tax rate, but also the tax base can be relevant to determine appropriate taxation of the underlying profits. Therefore some MS set requirements as regards the tax base, e.g. the requirement that the tax base of the subsidiary is comparable to – or at least not more beneficial than – the domestic tax base. Another example is the requirement that the subsidiary or its profits are not subject to a special tax regime.

The Group could consider requiring some sort of qualitative tax base condition next to a tax rate condition, with the exact requirements to be determined by the MS in question. The Group could also pursue a coordinated approach in this regard.

f) Relevance of the subsidiary's activities

Some MS make the application of their switch-over provision or CFC provision dependant on the business activities performed by, the type of income earned by and/or the assets owned by the subsidiary. All three elements can be described either positively (defining good activities/income/assets) or negatively (defining bad activities/income/assets). If certain specified tests for these elements are not met, a sanction may apply (anti-abuse kicks in or the switch-over provision applies).

The Group could discuss whether the full exemption for intercompany dividends should be limited to subsidiaries meeting one or more of the above tests with a view to differentiating between real economic activities and passive, mobile activities. The Group could also discuss whether there is sufficient support to pursue a coordinated standard in this respect⁴.

g) Relevance of applying the above tests also to lower tier subsidiaries

⁴ Art. 82 of the CCCTB proposal to that extent states that CFC provision applies if – in addition to other requirements – more than 30% of the income accruing to the CFC falls within one or more of specified categories of income (mainly passive income such as interest, royalty and dividend income) and more than 50% of the entity's income falling within these categories comes from transactions with associated enterprises. In the compromise proposal by the DK Presidency (doc. 8387/12, FISC 49) the associated enterprises test only applies to specified financial institutions.

Dividends are normally received from direct subsidiaries only. Consequently, the conditions to identify a qualifying subsidiary to which the participation exemption applies regard features of that subsidiary only. Business, however, could easily circumvent these conditions by interposing a qualifying subsidiary in the structure to ensure tax free repatriation of profits from non-qualifying (lower tier) subsidiaries. For this reason most CFC provisions and some other anti-abuse (switch-over) provisions also apply directly or indirectly to lower tier subsidiaries.

The Group could discuss the need for provisions also affecting lower tier subsidiaries as a precondition for being "effective".

- **Do MS agree that all or some of the above mentioned elements could be relevant when designing effective anti-abuse or counter measures to be combined with a participation exemption?**
- **Do MS consider one or more of these elements essential in the sense that they should be present in all anti-abuse provisions of all MS?**
- **Do MS agree that there is a need for more coordination in defining the critical criteria in these essential elements to ensure a more coherent approach of MS anti-abuse measures especially vis-à-vis third countries?**

[...]