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Contribution to agenda point ' Future of the Code of Conduct '

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 1997¹. 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 savings² and a Directive for interest and royalty payments between associated companies³. 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 measures⁴ 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,

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.

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.

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 months 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 procedure⁵, 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.

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

⁵ ECOFIN Council conclusions, 9 March 1998, OJ 98/C 99/01

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"⁶. 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.

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.

⁶ C(2004)434

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 notes⁷.

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

⁷ Consolidated application note: guidance in applying the 1998 report to preferential tax regimes (OECD, 2003)

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.

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.