

**ROOM DOCUMENT # 5 + Annexes 1 and 2**  
**Code of Conduct Group (Business Taxation)**  
**20 March 2013**  
**ORIGIN: Commission**

**WORK PACKAGE 2011 – PREPARATION OF GUIDANCE NOTES**  
**REVISED DRAFT GUIDANCE**

**Introduction**

1. On 19 December 2011 the Council approved the Code of Conduct Group's 2011 Work Package as set out in the annex to document 17081/1/11 REV 1 FISC 144. Point 4 of the Package concerned the preparation of guidance or application notes. It stated that:

*While noticing that past assessments will not be affected, the Group will undertake efforts to consolidate, per type of regime, various case-by-case assessments into general guidance or application notes for future use. Initially, these efforts will concentrate on regimes concerning income from mobile capital (intangibles and debt claims) and on regimes for free zones or special economic zones.*

2. At the Code Group meeting on 17 April 2012, the Group held an initial debate on this matter. It agreed to limit work to four different categories (interest regimes, royalty regimes, intermediary regimes and special economic zones). It discussed and agreed the overview of regimes for these categories and the annotated descriptions and characteristics prepared by the Commission as an annex to room document 5 of 17 April 2012. The Group decided to move forward by asking the Commission to prepare the necessary documents for that purpose.
3. The Commission therefore prepared draft guidance which was discussed at the meeting of 10 September and again at that on 17 October 2012 following Member States' written comments on the draft. At the second meeting it was agreed that the Commission would revise the draft guidance taking Member States' comments into account.
4. The revised guidance was presented in room document 2 at the meeting on 8 November 2012. Several MS raised points at the meeting. A deadline for the submission of written comments after the meeting was set as 16 November 2012.
5. A second revised text was presented in room document 5 of 30 January 2013. Following interventions by a number of Member States at the meeting it was agreed that additional written comments should be sent to the Commission by 1 March 2013.

**Comments received**



[Redacted]

#### **Revised version of the guidance**

[Redacted]

[Redacted]

[Redacted]

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#### **Rationale for paragraph 15**

[Redacted]

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[REDACTED]

[REDACTED]

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[REDACTED]

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**Draft guidance for regimes concerning interest, royalties,  
intermediaries and special economic zones**

**I. Introduction**

*Purpose of the Guidance*

1. The guidance set out below is based on past decisions of the Code of Conduct Group and is intended to improve the transparency of the Code Group's work. It is also intended to help Member States as well as third countries identify more easily potentially harmful tax measures covering beneficially owned income received under four specific types of regime.<sup>1</sup>
2. The guidance neither replaces the principles and criteria of the Code of Conduct nor prejudices the harmfulness of any particular regime. The guidance presents a non-exhaustive list of elements and characteristics which indicate that a tax measure may be harmful when fully assessed<sup>2</sup> against the criteria in the Code. Every assessment will continue to be based on the five criteria of the Code of conduct on a case-by-case approach.
3. The purpose of the text is to provide a guide for the application of the criteria in the Code but it does not go beyond those criteria nor does it limit them. The guidance can never provide a safe harbour for a particular regime. A tax measure that is the object of particular scrutiny or that requires particular attention under the guidance may be found non-harmful by the Code Group; likewise a measure that is not the object of particular scrutiny or that does not require particular attention under the guidance may be found to be harmful when assessed by the Group.
4. The purpose of the guidance is not to confine the Group to applying pre-determined general criteria; rather it should continue to subject each particular regime to a case by case examination against the Code criteria in the light of the Group's guiding principles set out in document 16410/08 FISC 174.<sup>3</sup>

*Relationship with past assessments*

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<sup>1</sup> IT & LU.

<sup>2</sup> LU.

<sup>3</sup> BE & LU.

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5. As the Work Programme originally noted past assessments, and regimes for which the Group has agreed in the past that there was no need to assess, will not be affected by the guidance. Likewise, only regimes that have not been considered by the Group cannot be regarded as complying with the Code on the basis of this<sup>4</sup> guidance. The current procedure for reopening past assessments remains in place.

### *Review of Guidance*

6. The countering of harmful tax measures is an ongoing process; therefore the guidance notes could be periodically reviewed by the Code Group to ensure that they reflect future developments.

## **II. Regimes offering privileged treatment for interest income**

7. In view of the high mobility of capital and their potentially significant harmful effects for other Member States, tax regimes of a Member State providing beneficial treatment (within the meaning of paragraph B of the Code of Conduct) for interest income compared to the general tax treatment for business income in that Member State will be the object of particular scrutiny by the Code of Conduct Group, taking special account of the circumstances listed in paragraphs 9 to 11 below.
8. Beneficial treatment, whether granted by law or as an administrative practice, includes but is not limited to:
- a. the non-inclusion in or exemption from the tax base of interest income, whether in whole or in part;
  - b. situations in which the tax base for interest income is determined in an artificial way, for example, if it is not determined using the arm's length principle or if it relies on a formulary approach such as pre-determined margins or non-arm's length mark-ups on operating<sup>5</sup> expenses, or;
  - c. the allowance of a deduction for deemed expenses such as deemed interest or management charges, a contribution to a risk reserve or deemed profit allocations to or from foreign

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<sup>4</sup> BE.

<sup>5</sup> IT.

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permanent establishments where this departs from internationally accepted principles, notably the rules and guidance agreed within the OECD <sup>6,7</sup>

9. In view of the Code's substance criterion and the high mobility of capital, interest regimes will require particular attention especially where, whether in law or in fact, the beneficial treatment is not generally available and targets non-trading interest income. This would be the case if the regime:
  - a. does not allow domestic commercial activities or;
  - b. does not require substance in terms of<sup>8</sup> economic presence.
10. In view of the high risk of international tax planning and its corresponding potential harmful effects on other Member States, such regimes will require particular attention especially where, whether in law or in practice, the beneficial treatment is not general and benefits intercompany and cross border interest income. A non-limitative and non-cumulative list of indicators in this respect are:
  - a. the regime does not apply to all companies, for example, if it requires the beneficiary to be part of an international group;
  - b. the regime does not apply to all interest income, for example when it ~~mainly affects~~ only applies to foreign source interest income or to financial transactions carried out with non-residents, or;
  - c. the beneficial regime is linked to specific limitations on the deduction of domestic expenses.
- ~~11. In view of the Code's reference to the location of business activity in the Community a tax measure may be potentially harmful if it is not genuinely intended to contribute to a Member State's economic objectives such as the stimulation of economic growth or innovation. Indicators of a fiscal purpose rather than a genuine intention to promote economic objectives might be:~~
  - ~~a. the policy purpose underlying the legislation, as supported for example by consultations and data prepared when introducing the regime;~~

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<sup>6</sup> IT.

<sup>7</sup> LU & NL.

<sup>8</sup> LU.

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~~b. evidence that the regime leads to *de facto* ring fencing, i.e. the majority of the companies under the regime are foreign owned.~~

### III. Regimes offering privileged treatment for royalty income

12. In view of the relatively high mobility of intangibles and their potentially significant harmful effects for other Member States, tax regimes of a Member State providing beneficial treatment (within the meaning of paragraph B of the Code of Conduct)<sup>9</sup> for royalty income compared to the general tax treatment for business income in that Member State will be the object of particular scrutiny by the Code of Conduct Group.
13. Beneficial treatment, whether granted by law or as an administrative practice, includes but is not limited to:
  - a. the non-inclusion in or exemption from the tax base in whole or in part of royalty income;
  - b. situations in which the tax base for royalty income is calculated in an artificial way, for example, if it is not determined using the arm's length principle or it relies on a formulary approach, such as pre-determined margins or non-arm's length mark ups on operating<sup>10</sup> expenses;
  - c. the allowance of a deduction for deemed expenses such as deemed interest expenses, deemed management charges, a contribution to a risk reserve or deemed profit allocations to or from foreign PEs where this departs from internationally accepted principles, notably rules and guidance agreed within the OECD<sup>11 12</sup>.
14. In view of the high risk of international tax planning and its corresponding potential harmful effects for other Member States such regimes will require particular attention, especially where in law or in fact the beneficial treatment is not general or targets intercompany or cross border royalty income. A non-limitative and non-cumulative list of indicators in that respect are:

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<sup>9</sup> NL.

<sup>10</sup> IT.

<sup>11</sup> IT.

<sup>12</sup> LU & NL.



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- a. the regime does not apply to all companies, for example it requires the beneficiary to be part of an international group;
  - b. the regime does not apply to all such income, for example when it only applies to ~~mainly affects~~ foreign source royalty income or to license agreements with non-residents, or;
  - c. the beneficial regime is linked to specific limitations on the deduction of domestic expenses.
15. Furthermore, in the light of the potential value of such regimes in stimulating real economic activity such as R&D, economic growth and innovation, such regimes will require particular attention if they display any<sup>13</sup> of the following non-exhaustive list of indicators;
- a. the regime does not contribute – *de-jure* or *de-facto* – an economic advantage for the Member State such as the stimulation of R&D because, for example, it attracts passive income rather than material investments in scientific research activities;
  - b. the regime does not allow domestic commercial activities or even does not require substance in terms of<sup>14</sup> economic presence;
  - c. the legislative motivation and data prepared when introducing the regime does not clearly demonstrate the economic motive;
  - ~~d. the regime is not limited to self-developed intangibles, or;~~
  - ~~e. the regime does not require the performance of activities related to monitoring, preserving and maintaining the intangible and its income streams in a manner that is in line with the nature and value of the intangible.~~
16. To ensure sufficient transparency the conditions of the regime must be clear and based on objective terms and conditions. A non-exhaustive list of indicators of a potentially harmful lack of transparency includes;
- a. a lack of any limitation in the regime to intangibles officially registered in a formal Register
  - b. the lack of transparent and objective regulations for embedded royalties in line with OECD standards, and;

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<sup>13</sup> COM (5 March 2013).

<sup>14</sup> LU (change in line with that in paragraph 9c; identified at meeting of 30 January 2013)

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c. a lack of an audit process to ensure correct application of the regime, including a risk assessment approach.<sup>15</sup>

17. The significance of the beneficial treatment available under the regime (e.g. effective tax rate available both in absolute terms and in relation to the generally applicable rate) must be considered in relation to the its overall positive economic effects. it being understood that the size and openness of a Member State have to be taken into account. ~~If the beneficial treatment is not proportionate to the economic objectives attained this may be evidence that a regime is potentially harmful.~~

### IV. Regimes concerning intermediate financing or licensing activities

18. Regimes providing advance certainty to intermediary financing or licensing activities, whether by law or by administrative practice, will in principle be the object of particular scrutiny by the Code of Conduct Group if one or more of the following circumstances apply:
- a. the regime provides for a standard approach including fixed spreads for intermediary type companies rather than relying on a case by case approach taking account of all the facts and circumstances involved with particular regard to the functions performed and risks assumed;
  - b. advance certainty provided by a tax administration concerning the profits reported by an intermediary company does not comply with the OECD Transfer Pricing Guidelines throughout the period to which it relates including the use of an inappropriate transfer pricing methodology.
  - c. advance certainty provided by a tax administration is granted *de jure* or *de facto* without any terminal date or with automatic renewal. Similarly if a renewal were granted on application it would be potentially harmful if such cases were not periodically reviewed by the tax authority to ensure an individual examination of the underlying facts and to check the conditions are at arm's length.
  - d. The regulations covering the conditions for granting advance certainty for intermediary companies are not publicly available;

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<sup>15</sup> UK (30 January 2013).

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- e. The regulations covering the conditions for granting advance certainty for intermediary companies does not ensure effective exchange of information of the methodology applied and of the arm's length profit agreed with other concerned MS.
- f. The regime is not equally available (whether on a *de jure* or *de facto* basis) to domestic commercial activities or requires no substantial domestic presence.

### **V. Tax privileges related to special economic zones**

19. Without prejudice to the specific and detailed State Aid rules based on Article 107 TFEU, business tax privileges available for a special geographic area of a Member State ("special economic zones") will be the object of particular scrutiny by the Code of Conduct Group when one or more of the following circumstances are met:
- a. access to the zone, either *de jure* or *de facto*, specifically favours foreign investors or discriminates against domestic investors or the tax benefits available to companies operating in the zone specifically favour transactions with non-residents or discriminate against domestic transactions;
  - b. the regulations for the zone place restrictions on activities that require a substantial economic presence or highly mobile activities typical of the banking or insurance industry or intra-group services are permitted in the zone;
  - c. there is a lack of regular tax audits verifying that the profits accruing in the zone are commensurate with the business activities carried on within in it;
  - d. the terms and conditions for establishing a zone, for being allowed to operate in the zone and the benefits available for companies operating in a zone are not clearly defined in public legislation, are not limited in time and permission to establish a zone or to be active in a zone is subject to discretionary powers.



## Annex 2

MS	Para	Comments	COM's response
LU	1	Revised wording in opening sentence proposed by COM in response to LU's comments on paragraph 17.	Accept.
IT	1	IT comments were made in respect of the intermediaries regime – recognises that beneficial ownership of the relevant income is implicit in the guidance but asks for some wording (upfront somewhere in the document) stating the “scope” of the guidance in this respect.	Accept.
LU	2	Insertion of "possibly" before "indicate...may be harmful"; replace "considered" with "assessed" and insert "exclusively" to emphasis reliance on Code criteria.	Reject "possibly" as conditionality already present in " <i>may</i> be harmful"; accept "assessed" as more accurate word; reject "exclusively" as unnecessary.
LU	4	Asks for explanation of paragraph's purpose in the light of the last sentence of paragraph 2.	Paragraph 4 was added simply for emphasis hence degree of repetition with preceding paragraphs.
BE, LU	4	Insertion of reference to document 16410/08 in response to comments on paragraphs 11 and 17.	Accept.
BE, LU, NL	5	Insertion of reference to regimes which the Group has decided not to assess.	COM's view is that this addition is unnecessary. No regime can be revisited whether or not it has been formally assessed by the Group without a broad consensus in the Group. A commitment never to look again at regimes that have not been assessed does not accord with the consensual approach taken by the Group.

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MS	Para	Comments	COM's response
BE, LU, NL	5	Insertion of "only" into second sentence.	COM is not entirely certain what this change means. It appears to distinguish between regimes which the Group has decided not assess with regimes which have not been discussed at all (e.g. regimes that were never notified or regimes in third countries). COM thinks that BE, LU and NL believe that only regimes that have been never been discussed at all should not be considered as complying with the Code.
BE	5	BE queried the phrasing of the second sentence.	The comment was intended to prevent regimes that had not been considered by the Group from being portrayed as Code compliant because they satisfy the guidance. The sentence has been amended to make this clear.
IT	8b	Proposed additional wording for clarification purposes; avoid suggesting that “pre-determined” applies only to margins and not to mark-ups.	Accept.
LU	8c	Deletion of reference to asymmetric treatment as a recent addition to the text and not based on either past assessments or criteria in the Code.	Accept.
IT	8c	Suggested amendment as the current reference to the OECD TP guidelines will not cover article 7 of the OECD MTC; change to "rules and guidance agreed within the OECD".	Accept.

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MS	Para	Comments	COM's response
NL	8c, 13c	Suggest deleting the phrase “or where this could foreseeably lead to asymmetric treatment” as it is unclear and difficult to establish.	Accept.
LU	9b, 15b	Insert "appropriate for the type of activities" to describe an economic presence.	Disagree but see alternative proposed text. In the light of paragraph B3 of the Code it is appropriate that the Guidance reflects the Group's interest in activities that require little substance as they typically involve mobile passive income.
BE, LU, NL	10	Qualifying harmful effects of avoidance as "potential".	Disagree; the document's concern is with the harmful effects of international tax planning not with any beneficial impact that it may have on MS. This is not a question of legal <i>versus</i> illegal actions but of the harmful consequences for MS.
LU	10	Deletion of reference to <i>de jure</i> and <i>de facto</i> tests ("whether in law or practice").	Disagree; LU has never accepted the <i>de facto</i> interpretation of criteria 1 and 2 but this does not reflect the consensus in the Group.
BE, LU, NL	10b	Delete "mainly effects" and replaces with "only applies to" in describing what an interest regime covers (e.g. 'mainly effects foreign source income' rather than 'only applies to foreign source income').	Disagree; the original wording was intended to ensure that a regime which permits small amount of domestic income will still be covered.

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MS	Para	Comments	COM's response
BE, LU, NL	11, 11a, 11b	Deletion of paragraph.	<p>Disagree in part. Paragraph 11 relies on paragraph B3 of the Code which refers to the granting of tax advantages without any real economic activity being undertaken.</p> <p>Regarding paragraph 11a, statements made by MS during the legislative process (e.g. during consultation) may well help the Group understand the purpose of a particular measure as well as its likely or actual practical effect.</p> <p>Regarding paragraph 11b, COM believes that the emphasis in paragraphs 1 to 4 on the Code and the agreed "guiding principles" in document 16410/08 make it clear that paragraph 11b cannot itself make a regime harmful.</p> <p>However COM also recognises that the sentence is worded very broadly. COM would therefore propose retaining paragraphs 11, 11a and 11b with the exception of the words "i.e. the majority of the companies under the regime are not foreign owned" in 11b.</p>
LU	11, 11b	Deletion of "genuine" and "genuinely".	<p>Disagree with specific changes but accept the wider point about 16410/08, see below paragraph 17.</p>



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MS	Para	Comments	COM's response
NL	11, 16	Suggest deleting both as they believe the paragraphs will present practical problems, e.g. the burden of proof still lies with the Member States and the meaning of "genuine" (paragraph 11) is unclear.	Reference to paragraph 16 probably meant to say 17 as these comments reflect NL's earlier comments on para 3c of the old guidance (now para 17). Do not agree that the paragraphs should be removed. Most MS will monitor the effectiveness of tax incentives they have introduced so information is likely to be available on the <i>de facto</i> impact of a regime. Ultimately the question would be whether the information available convinces the Group members.
IT	13b	As for paragraph 8b above.	Accept.
IT	13c	Changes to make the text consistent with proposals for paragraph 8c.	Accept.
LU	13c	Deletion of reference to asymmetric treatment as a recent addition to the text and not based on either past assessments or criteria in the Code.	Accept.
BE, LU, NL	14	Qualifying harmful effects of avoidance as "potential".	Disagree; the document's concern is with the harmful effects of international tax planning not with any beneficial impact that it may have on MS. This is not a question of legal versus illegal actions but of the harmful consequences for MS.

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MS	Para	Comments	COM's response
BE, LU, NL	14b	Delete "mainly effects" and replaces with "only applies to" in describing what an interest regime covers (e.g. 'mainly effects foreign source income' rather than 'only applies to foreign source income').	Disagree; the original wording was intended to ensure that a regime which permits small amount of domestic income will still be covered.
COM	15	Insertion of the words "if they display any".	These words make have been added to make it clear that the factors listed in paragraph 15 should be considered by the Group when deciding whether or not to consider a particular measure in more detail.
LU	15b	Change analogous to that in paragraph 9b.	See 9b above.
BE, LU, NL	15d, 15e	Deleted.	Reject. These do not add additional criteria to the Code but identify possible features of a regime which may be of interest to the Group. Any subsequent assessment of that regime would rely on the criteria in the Code. See additional comments, pages 2 and 3 above.
UK	16c	Suggests changes to wording to take account national rules which operate on a self-assessment basis.	Accept.

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MS	Para	Comments	COM's response
BE, LU, NL	17	Insert reference to taking account of size and openness of a MS.	Accept in principle and addressed in the introductory comments to the effect that the Code remains paramount and new text saying that this that includes procedural matters outlined in document 16410/08. The economic effects of a particular measure can only be understood in the context of the MS to which they apply. This covers not just absolute factors such as the size of the MS but also dynamic factors such as the state of its economy.