ROOM DOCUMENT # 5
Code of Conduct Group (Business Taxation)
30 January 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REVISED DRAFT GUIDANCE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 and asked the Group to start working on this package during the Danish Presidency (18398/11 FISC 167). Point 4 of the Work 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 process. 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. To that extent, the Commission prepared draft guidance which was discussed at the meeting of 10 September and again at that on 17 October 2012 following Member States' written comments on the draft. At the second meeting it was agreed that COM would revise the draft guidance and clarify its status, taking Member States' comments into account.

4. This 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.

Comments Received

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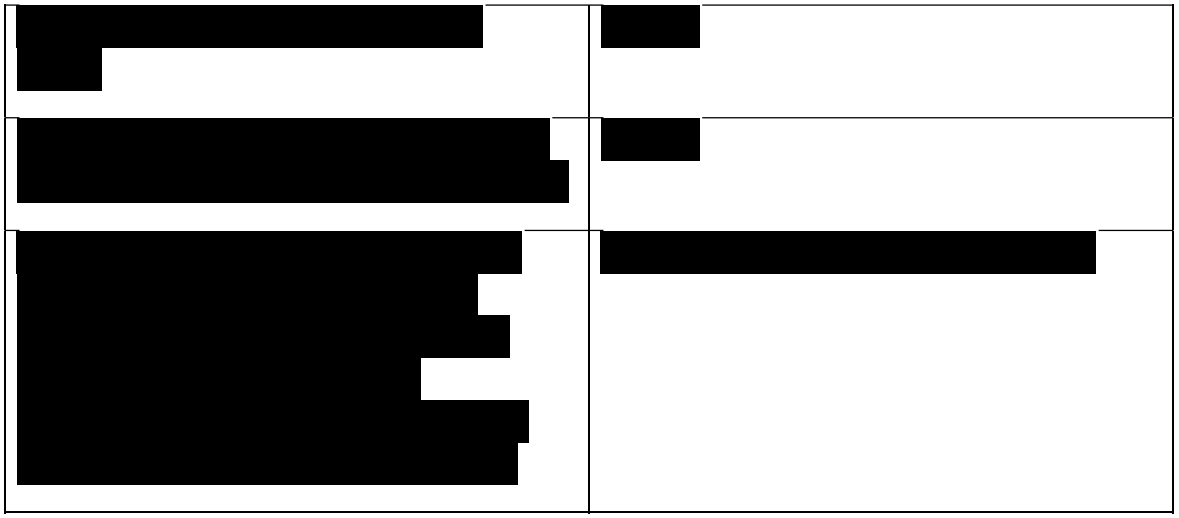

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Draft guidance for regimes concerning interest, royalties, intermediaries and special economic zones

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.[1]

2. The guidance neither replaces the principles and criteria of the Code of Conduct nor prejudges 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[2] 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.[3]

[1] IT.

[2] LU.

[3] BE & LU.

Relationship with past assessments

5. As the Work Programme originally noted past assessments will not be affected by the guidance. Likewise, regimes that have not been considered by the Group cannot be regarded as complying with the Code on the basis of this[4] 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

[4] BE.

approach such as pre-determined margins or non-arm's length mark-ups on operating[5] 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 permanent establishments where this departs from internationally accepted principles, notably the rules and guidance agreed within the OECD [6].[7]

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[8] economic presence.

10. In view of the high risk of international tax planning and its corresponding 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 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.

[5] IT.

[6] IT.

[7] LU & NL.

[8] LU.

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;

b. evidence that the regime leads to *de facto* ring-fencing, i.e. the majority of the companies under the regime are [9]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)[10] 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[11] 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[12].[13]

[9] COM (typographical error identified at meeting of 8 November 2012).

[10] NL.

[11] IT.

[12] IT.

[13] LU & NL.

14. In view of the high risk of international tax planning and its corresponding 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:

    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 mainly affects to 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 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 substantial 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;

c. a lack of regular audit processes including a material check that all conditions have been met before the regime is applied.

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. 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;

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.

Additional Comments by Members States following Meeting of 8 November 2012

[redacted]

Au point 5 de l'annexe 1 (intitulée "*Draft guidance for regimes concerning interest, royalties, intermediaries and special economic zones*"), vos services écrivent que les "*past assessments will not be affected by the guidance. **Likewise, regimes that have not been assessed will not be cleared by the guidance***". Pour la délégation belge, il n'est pas normal de traiter plus favorablement un régime fiscal qui a fait l'objet d'une évaluation positive de la part du Groupe Code de Conduite (*not affected*) par rapport à un régime fiscal pour lequel ce même Groupe est arrivé à la conclusion qu'il n'était pas nécessaire que cette mesure soit évaluée selon les critères du Code[1] (*not cleared*). La conclusion des services de la Commission n'est pas logique. Les régimes fiscaux pour lesquels le Groupe est arrivé à la conclusion qu'il n'était pas nécessaire qu'ils soient évalués selon les critères du Code ont fait l'objet d'une description et d'une analyse préliminaire de la part du Groupe. A la suite de cette description et de cette analyse préliminaire, le Groupe est arrivé à la conclusion qu'il était évident que ces régimes n'étaient pas dommageables et qu'il n'était donc pas nécessaire de les évaluer. De plus, remettre ces régimes en question poserait un problème de sécurité juridique pour les opérateurs économiques qui bénéficient de ces régimes fiscaux. La Belgique souhaite donc la suppression de la phrase ***Likewise, regimes that have not been assessed will not be cleared by the guidance***.

Au point 11 b de l'annexe 1, vos services écrivent qu'une preuve qu'un régime fiscal mène à un cantonnement (*ring fencing*) de facto serait que ***the majority of the companies under the regime are foreign owned***. Une telle affirmation est inacceptable pour la Belgique. La Belgique a une économie ouverte et une part importante des sociétés est détenue par des actionnaires non-résidents. Pour un régime fiscal belge donné, il est donc probable que la majorité des sociétés bénéficiant de ce régime soient détenues par des étrangers et le critère 2b du Code risque d'être systématiquement satisfait. Une telle interprétation d'un critère du Code pourrait aboutir à une situation où un même régime serait jugé dommageable dans une économie ouverte et de petite taille alors que ce même régime serait jugé non dommageable dans une économie plus grande et moins ouverte. Le Belgique demande donc la suppression de la partie de la phrase qui stipule que ***the majority of the companies under the regime are foreign owned***.

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[1] Underlined text highlighted by Luxembourg delegation.

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