**ROOM DOCUMENT # 2**
**Code of Conduct Group (Business Taxation)**
**4 March 2010**
**ORIGIN: Commission Services**

# Administrative practices

## Way forward

### 1. Introduction

The issue of Administrative Practices is one of six items in the Future Workpackage adopted by the ECOFIN Council in December 2008. The Code Group was requested to work on the Workpackage during the Czech, the Swedish and the Spanish presidency and to report back to the ECOFIN Council on the outcome by the end of the Spanish presidency.

During the Code meeting on 18 November 2009, the Group held an initial exchange of views on this issue. The discussion focussed on MS replies to a questionnaire prepared by the Commission Services. At that stage, no concrete conclusions could be drawn, nor did the Group agree on specific follow-up actions. Instead, given the lack of clarity amongst some delegations, the Group asked the Commission for further background information and guidance on three separate issues:

- Guidance for a more unambiguous definition of a "harmful" administrative practice or a "harmful" ruling;
- Suggestions for improvements in the field of transparency of administrative practices; and
- Elaborate on possibilities for improving the exchange of information especially regarding administrative practices with a cross border element.

The present paper contains ideas for these three areas in order to enable a more focussed discussion during the Code meeting of 4 March 2010. This would also benefit the work on Links to third countries since harmful elements in third country regimes may frequently involve administrative practices.

### 2. Definition of harmful rulings

*2.1 Introduction*

In Roomdoc # 7 of the Code meeting on 15 May 2009, it was proposed to limit the wider area of administrative practices to rulings. When defining (harmful) rulings, a first important distinction is between rulings on the one hand and APAs (or other advance agreements on transfer pricing) on the other. The first category is understood to concern the advance interpretation or application of tax provisions by the tax administration to a specific fact pattern of a specific tax payer. The second category concerns the advance agreement on an arm's length price for one transaction or a series of transactions between related companies. The topic of administrative practices only concerns the first category. The second category of APAs has been discussed separately and it was agreed that the lack of experience with the practical aspects of spontaneously exchanging information in the area of Transfer Pricing will be improved by providing technical assistance in the context of the Fiscalis program in the form of a project group (Code Group Report of 18 November 2009, 16233/09 FISC 163).

In previous Code documents and discussions, the harmfulness of rulings was established by assessing whether legal provisions are relaxed at administrative level in a non-transparent way[1]. This view whereby the criteria for harmfulness of rulings are (i) a lack of transparency and (ii) the provision of a too liberal interpretation of a legal provision, is also reflected in the mandate under the current Future Workpackage:

> "Preceded by a comparative study on transparency of administrative practices, the Group would revisit the work done in 1999 when Member States provided comments on a comparative study across Member States of administrative practices in taxation, and discuss *the extent to which Member States' administrative practices, including practices at regional or local level, relax measures to the point that they may be considered harmful*."

It seems useful to take a closer look at both elements.

*2.2 The lack of transparency*

The element of transparency is crucial in the context of harmful tax competition. It is even specifically mentioned in the Code of Conduct as criterion number B5. Thereby it seems important to recall that whereas the lack of transparency (a 'tick on transparency' in Code terms) is a strong indicator for harmfulness, the opposite is not necessarily true. A transparent practice is not by definition 'not harmful'.

Transparency further seems to have two aspects.

1. In the first place, the procedure for granting rulings must be embedded in a transparent legal and administrative framework, meaning public legislation or administrative guidelines. They should determine for which situations rulings are given, who is responsible for granting the rulings and what the process is by which a ruling is applied for and granted. One could refer to this aspect as "*de-jure transparency*".
2. Secondly, the actual application of these regulations should be performed in a transparent manner as well. Individual rulings should be reviewable by the public and by other Member States, within the limits of appropriate secrecy and confidentiality on data of individual tax payers. One could refer to this aspect as "*de-facto transparency*".

Again, it is true that transparency as such does not tell you anything about the intrinsic harmful nature of a ruling. The rationale behind the importance conferred to transparency, however, is that rulings with harmful effects would most likely be granted under a significant degree of administrative discretion and secrecy and might less likely exist in Member States which operate on an open basis, with a culture which requires or encourages the publication of rulings. Paragraph 3 further addresses the issue of transparency.

*2.3 Ruling relaxes measure to a point considered harmful*

The real question of when a ruling (practice) is to be considered harmful is obviously in this element. A normal, straightforward application of a tax provision in a specific case which provides certainty in advance logically can not be considered harmful. If anything, the underlying tax provision would be harmful, not the application of it. However, it seems plausible that advance certainty will be sought especially in cases that are not straightforward. If the case is clear, an advance ruling would not seem to bring any extra benefit. And it is in these cases where there is a relatively wide margin of appreciation that a beneficial ruling for a tax payer could be considered harmful.

[1] Report from the Code of Conduct Group (Business Taxation) to the ECOFIN Council on 29 November 1999 (SN 4901/99 of 23.11.1999.

MS should be reminded that such harmful rulings are not necessarily simple contra-legem rulings, that is an administrative interpretation that is in clear conflict with a specific tax provision or with the complete tax law. For example tax authorities agree that thincap rules will not apply to a specific loan investment despite the fact that it would legally be covered or agree on a tax rate different from the statutory rate. Such a practice would clearly be harmful, but most MS have explicitly stated that their tax inspectors do not have the discretionary powers to grant such rulings. More difficult to identify are rulings which can not be considered contra legem.

In an attempt to provide more guidance for determining when a ruling is harmful, the Group could consider to focus on rulings that concern the application of a provision:

(a) Which leads to a beneficial result for a tax payer, and

(b) Which is granted with the actual intention of providing an incentive for the taxpayer,

(c) The result of which appears to be in conflict with the purpose and aim of the provision in question or with balanced international taxation, and

(d) Which meets one or more of the 5 Code criteria (grids).

*Example:*

An example of such a ruling could be a ruling whereby the tax administration of MS X agree that the presence and activity of a non-resident company in X does not give rise to a taxable presence (a PE). This is not necessarily contra legem, because the presence of a PE does leave a certain margin of interpretation. However:

(a) The ruling does present a benefit to the foreign company (no taxation), especially if the tax payer takes the reverse position in its country of residence and claims exemption there.

(b) Probably such a ruling would be granted with the specific aim of providing an incentive, maybe because the ruling increases the likelihood of further investments.

(c) If the ruling leads to double non-taxation, this would clearly be in conflict with the PE concept in international taxation.

(d) The ruling would meet criteria 1 and 2 of the Code as it is only available to non-residents. Also it might meet criterion 4 regarding the proper profit allocation to a PE and criterion 5 for a lack of transparency.

Points for discussion:

- Do MS agree that a clearer, more specific definition of 'harmful rulings' in the context of administrative practices is needed?
- If yes, MS are invited to comment on the suggested elements for such a more precise definition..

**3. Improvements in the field of transparency**

From the replies of the MS to the questionnaire, it follows that the approach towards transparency on rulings differs a lot. The various policies applied might be analysed and some form of coordination might be considered, for example via best practices.

However, in order to make this a useful exercise, a complete overview of practices applied would be needed. Since the last discussion in the Code Group on this topic on 18 November 2009, Denmark and UK have sent in replies. Greece has provided some comments on the 1999 Simmons & Simmons study, but has not yet been able to reply to the questionnaire. No reply has been received from Belgium. An updated overview of replies received has been enclosed as Annex 1.

Even though most MS have now replied to the questionnaire, a point of concern is that not all MS have provided information that is suitable to allow the Group to come to a sensible judgement. Some MS have in their replies only stated that they do not grant harmful rulings. For that reason they have not given insight in what sort of advance clearance they do grant. Those MS could be invited to provide a comprehensive factual description of the administrative practice they operate, especially indicating the type of rulings they do grant and how the transparency of those rulings has been regulated. This would allow the Group to obtain a complete overview of the practices in place and to propose coordination where appropriate. It seems that such a complete overview of all 27 MS would be needed to make progress in this area.

Point for discussion

- Some MS have provided a clear description on the "de-jure" transparency of rulings granted providing a detailed description of how the granting of advance rulings has been organised and how many and which type of rulings they grant (e.g. FR); other MS have given little or no insight at all. The Group could invite those MS to also provide this information, which would greatly facilitate the Group to have an exchange of views and propose coordination where appropriate.

The replies – again, though not complete – also show that MS operate different ways of publishing individual advance rulings. Some operate a high level of secrecy whereby the rulings are only exchanged with other (foreign) authorities upon request in an anonymous form. Others make all individual rulings publicly available on the internet, ranging from personal income tax rulings via rulings on VAT to rulings on corporate income tax. Again, some MS have not provided this type of information stating that any rulings they grant are not harmful. These MS could be invited to do so. Some MS have replied that the concept of advance clearance simply does not exist. In that case transparency is obviously not an issue. GR and BE have not sent in replies

The below table gives an overview of the policies MS apply towards publishing advance rulings. Since the exact practice differs in various details from MS to MS, the table is just a rough categorisation. For some MSs additional explanation has been given in footnotes. All MSs individual comments can be found in the Overview of Consolidated Replies.

*Table 1. Member States policy on publishing advance rulings*

| Published | Published (anonymous) if:<br>• General interest<br>• Horizontal issues | Available to all tax inspectors via a data base or on request | High level of tax secrecy | No input provided |
|---|---|---|---|---|
| | CY<br>DK<br>EE<br>FI<br>FR<br>IE[2]<br>NL[3]<br>PL<br>ES<br>SE[4]<br>UK | HU<br>LU<br>MT | CZ<br>DE | AT<br>BE<br>BG[5]<br>GR<br>IT<br>LV<br>LT[5]<br>PT<br>RO[5]<br>SK<br>SI |

Points for discussion

- The Group could invite MS that have not provided input regarding the "de facto" transparency of their practice to do so. also provide this information, which would greatly propose coordination where appropriate
- This would allow the Group to have an exchange of views and to intensify coordination e.g. by identifying best practices in this regard based on the following elements:
    - Where the advance interpretation of a legal provisions in a specific case is suitable for horizontal application in similar situations, the interpretation should be published.
    - In the context of the Code this applies especially to an interpretation whereby it is agreed to not enforce a legal provision to the ultimate extent possible.

## 4. Improving exchange of information for cross border rulings

During the last Code meeting it was mentioned that the instrument of Exchange of Information in the context of rulings could be deployed much more efficiently, if it specifically targeted rulings with a clear cross border element. Many practices of advance clearance concern the advance interpretation of a tax provision in a purely domestic setting. For example, advance certainty on the economic life of an externally acquired asset for depreciation purposes or on meeting the conditions for domestic loss carry forward provisions hardly seem to be of direct relevance for the tax authorities of other Member States. Therefore, in these cases it seems difficult to identify a "*directly concerned MS*" with whom this ruling would need to be exchanged. The foregoing does not mean

[2] By amending the Tax and Duty Manuals, issuing a statement of practice or technical guideline or amending published precedents.
[3] The policy how the tax law is to be interpreted in a specific factual situation is published, not the ruling itself.
[4] Rulings are similar to court judgments and may be appealed against in Court. They are anonymously published on the ruling committee's website. Exceptionally an advance ruling is not published at all for reasons of secrecy.
[5] Advance clearance is not available in any form.

that purely domestic rulings can never be harmful rulings. They might very well be. However, exchange of information does not seem to be the proper remedy for those purely domestic rulings.

Therefore, the Group could consider trying to identify specific types of advance rulings where a cross border element is present and where the tax treatment in the Member State giving advance clearance is likely to be relevant for the tax authorities of another MS in order to assure coherent overall taxation.

Most of the rulings with a cross border character will concern qualification or valuation issues. By means of a non-exhaustive list the following types of rulings could be considered:

- A ruling whereby MS 1 gives clearance on the absence of a PE in MS 1 to a company resident in MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).
- A ruling whereby MS 1 gives clearance on specific items of the tax base of a PE in MS 1 to a company resident in MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).
- A ruling whereby MS 1 gives clearance on the tax consequences of a hybrid loan granted by a resident of MS 1 to a resident of MS2 (exemption / deduction). Such a ruling could be relevant for the tax authorities of MS 2.
- A ruling whereby MS 1 gives clearance on the tax status of a hybrid entity resident in MS 1 which is controlled by residents of MS 2. Such a ruling could be relevant for the tax authorities of MS 2 (same applies in reverse situation).
- A ruling granted to a resident of MS 1 where the tax value for depreciation purposes is determined for an asset that is acquired from a group company in MS 2. Such a ruling could be relevant for the tax authorities of MS 2.

Points for discussion

- Do MS agree that the exchange of information in the area of advance tax rulings should only regard rulings with a cross border element?
- Do MS want to comment on the none-exhaustive list of rulings with a cross border element?
- Do MS foresee that data protection legislation would set limitations to the exchange of information in the area of cross border tax rulings?