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On June 17, 2022, the final scheduled meeting of the Economic and Financial Affairs Council of the EU (ECOFIN Council) under the French Presidency of the Council took place.

Despite Poland lifting previous reservations, Member States were unable to reach political agreement on the Minimum Tax Directive proposal due to a change in position by Hungary, which decided to veto the proposal despite having agreed to support the initiative at previous ECOFIN meetings.

During the meeting, the ECOFIN Council approved a report to the European Council (the ECOFIN report), which provides an overview of the progress achieved in the Council on a range of tax measures, including, from a direct tax perspective, the status of the Unshell Directive proposal, the launch of the European Commission's Debt-Equity Bias Reduction Allowance (DEBRA) proposal and political negotiations on the adoption of the Minimum Tax Directive.

The ECOFIN Council also approved a report by the Code of Conduct Group on its work performed during the term of the French Presidency (first half of 2022).

EU Minimum Tax Directive Background

The European Commission published the initial minimum tax proposal on December 22, 2021 after the OECD had published its Model Rules for the Global Anti-Base Erosion Rules (GloBE Rules) two days before, on December 20, 2021. Following technical discussions in the Council working groups, a compromise text was published on March 12, 2022 in advance of the March 15 ECOFIN meeting and provided for several amendments in order to make reference to the ongoing work of the OECD and to rectify areas of discrepancy between the Model Rules and the initial text.

Due to concerns raised by Member States in respect of the short implementation timeline, an option for Member States to defer the application of the IIR and the UTPR where a small number of Ultimate Parent Entities (UPEs) of in-scope MNE Groups are located in those Member States (optional IIR and UTPR deferral) was introduced (see the March 12 compromise text, as summarized in Euro Tax Flash Issue 468 for further details).

Following discussions in Council working groups, a revised compromise text (dated March 28, 2022) was discussed at the ECOFIN Council meeting on April 5, 2022 that provided for a deferral of up to six years where a maximum number of twelve UPEs are based in a Member State. For more information on the revised March 28 compromise text, please refer to Euro Tax Flash Issue 470.

Throughout the negotiation process, Poland expressed concerns regarding the adoption of the Directive independent of Pillar One and was therefore not in a position to agree to the compromise text that was accepted by all other Member States.

June 17 ECOFIN Meeting Outcome

Finance Ministers of EU Member States discussed a revised compromise text (which is currently not publicly available), which seeks to address the specific concerns raised by Poland regarding a link between the OECD Pillar One and Pillar Two proposals.

During the meeting, Commissioner for Economy, Mr. Paolo Gentiloni, noted the willingness of the European Commission to confirm its full political investment in both pillars, but stressed that this did not mean creating a legal link between the implementation of the two pillars in the EU. In order to formalize this commitment, the Commission advised that it will submit a statement to be attached to the minutes of the ECOFIN Council meeting, confirming their intention to put forward a legislative proposal on Pillar One once the work at OECD level is mature enough to proceed.

The European Commission also confirmed that it will continue to monitor closely negotiations on the Pillar One multilateral instrument and intends to submit a report on Pillar One to the ECOFIN Council by June 2023 and assess the situation accordingly with a view to submitting a related proposal, if needed. If Pillar One does not become reality at international level, the European Commission has stated that it is still committed to ensuring that the challenges arising from the digitalization of the economy are addressed.

In light of the amendments proposed to the compromise text and the commitments provided by the European Commission in relation to the implementation of Pillar One, Poland advised that it could lift its reservations.

However, in an unexpected development, the Hungarian delegation advised that it was no longer able to support the proposal at this time, citing concerns regarding the economic consequences of introducing the Minimum Tax Directive in the context of the impact of the unfavorable geopolitical situation in the region. Furthermore, Hungary noted the need for further work on substantial and procedural questions related to the new rules, as well as highlighting the expected delay in the Pillar One implementation timeline.

Code of Conduct Group Background

On December 1, 1997, the ECOFIN Council adopted conclusions on a legally non-binding Code of Conduct (the "Code") focusing on the identification and withdrawal of harmful tax measures. As a next step, the Code of Conduct Group ("CoCG" or the "Group") was set up on March 9, 1998 to focus on the Member States' commitment to eliminate existing harmful tax practices (rollback process), while refraining from implementing new ones (standstill process) in accordance with the Code.

In December 2017, Member States also agreed on promoting the adoption of transparency and good governance principles by third countries by way of a common EU list of non-cooperative jurisdictions for tax purposes. Since then, the list has been regularly revised based on the work performed by the Group (see Euro Tax Flash issue 466 for the latest developments).

On November 26, 2021, the Group's presented a proposal for a revised mandate of the Group, which provided, in particular, for an expanded definition of harmful tax regimes to cover features of tax systems that have general application and that may have harmful effects. At the ECOFIN Council meeting on December 7, 2021, however, Member States did not agree on the revised Code proposal.

The Group regularly reports to the ECOFIN Council on the work performed during each Council Presidency on the action areas that are within the scope of its mandate.

Work performed by the CoCG during the French Presidency

The Group's report, as approved by the ECOFIN Council on June 17, 2022 (Group's report) details the work performed during the French Presidency as follows:

Revision of the mandate of the Code of Conduct Group

The previously proposed revision of the mandate of the Group has not been part of its work program for the first half of 2022 during the term of the French Council Presidency. The Group's report notes, however, that the Group will resume its work on the revised mandate with a view to advancing the reform in due time.

Current state of the standstill and rollback review process

The Group's report notes that a number of newly identified tax measures do not need to be assessed by the Group, including Italy's option for an increased deduction of R&D costs relating to certain IP assets, Italy's amendments to the existing Notional Interest Deduction regime to apply the interest rate of 15 percent to increase of equity in 2021, Poland's robotisation tax relief, Romania's

exemption from payment of the tax specific to certain activities for the taxpayers in the field of HORECA and Slovakia's tax measure aimed at supporting investments in certain fixed assets.

With respect to the standstill review, the Group's report makes reference to a number of preferential tax measures due to be assessed (including Poland's holding tax regime and Croatia's newly introduced tax incentive for investment projects in the manufacturing industry). In addition, it was decided that the standstill review of Romania's profit tax exemption for companies with innovation and R&D activities is kept on hold until the relevant national legislation is adopted. The analysis of Ireland's digital games relief is also kept on hold until the related state aid process is settled.

As regards the rollback review process, the Group's report notes that Poland informed the Group that legislative work has been completed in relation to Poland's Investment Zone (PL013). The Group agreed that the rollback measures are sufficient and adequate for the rollback to be considered as completed.

Update on the Group's screening and listing exercise with regards to non-cooperative jurisdictions

The Group's report also details the work performed with regards to the revised EU list of non-cooperative jurisdictions ("Annex 1") and commitments taken by cooperative jurisdictions to implement tax good governance principles ("Annex 2" or "grey list"), which were approved by the ECOFIN Council on February 24, 2022 and published in the Official Journal on March 3, 2022 (for more details, please refer to Euro Tax Flash Issue 466).

In relation to **criterion 1.1** (automatic exchange of financial account information (AEOI)), the Group's report refers to the agreement on aligning the criterion with the AEOI peer reviews conducted by the Global Forum on tax transparency and exchange of information (Global Forum). The update of the criterion includes a two-step process, as defined in the guidance prepared by the Group and published in an annex to the Group's report. In a first step, the Group will evaluate the assessment by the Global Forum in the 2022 peer review report in relation to the implementation of the required domestic and international legal AEOI framework. Where a jurisdiction in scope does not meet the minimum level of compliance ("in place, but needs improvement"), the Group will require a commitment from that jurisdiction, which should be recorded in course of the grey list update in the beginning of 2023. The commitment should then be fulfilled in time to be reflected in the 2024 Global Forum peer review report. According to the guidance, the second step will be taken at a later stage where the Group will also consider the future Global Forum ratings on the effectiveness of the implementation of the AEOI standard.

For **criterion 1.4** (exchange of beneficial ownership information), which was already approved by the ECOFIN Council in November 2016, the Group's report highlights the importance of the criterion for strengthening the application of the EU listing criteria to tackle tax fraud, evasion and avoidance and notes that the Group agreed to continue the discussion on this issue.

On **criterion 2.1** (preferential tax regimes), the Group's report notes that Armenia and Eswatini would be asked for commitments to amend or abolish the regimes deemed harmful[1] by the OECD Forum on Harmful Tax Practices (FHTP).

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[1] Armenia's Free economic zones and Information technology projects regimes and Eswatini's Special Economic Zone regime).

In relation to **criterion 2.2** (tax regimes that facilitate offshore structures which attract profits without real economic activity), the Group's report notes that the FHTP conclusions on the enforcement of the substance requirements for the year 2019 will be considered for the October update of Annex 1 and 2 along with any progress made by the concerned jurisdictions up to this update. From 2023 onwards, the Group aims to update Annex 1 and 2 in the first quarter of a given year based on the FHTP conclusions reached in the last quarter of the year before. In addition, the Group agreed to conduct a screening exercise for trusts and fiduciaries to assess highly mobile activities, which have not yet been included in the scope of domestic legislation on economic substance requirements. The Group further decided to explore the impact of the FHTP guidance on pure equity holding companies and entities claiming tax residence in another no or only nominal tax jurisdiction and agreed on a monitoring process for the implementation of substance requirements in relation to Collective Investment Funds (CIVs). In this context, the Group's report notes that the European Commission will update the Group, on a regular basis, on the need to extend the monitoring exercise to other jurisdictions that might be relevant for criterion 2.2.

In addition, the Group's report highlights the Group's aim to evaluate possible impacts that the implementation of the OECD Pillar Two solution may have on the listing criteria, including criteria 2.1 and 2.2.

Overview of the defensive measures currently applied by Member States

The Group agreed to continue working on defensive measures against non-cooperative jurisdictions for tax purposes. As a first step, the Group considers an analysis on how defensive measures have been effectively applied by Member States to enable discussion on whether and how coordination of the measures could be enhanced.

For more information on defensive measures adopted by Member States, please refer to KPMG's summary of defensive measures against non-cooperative jurisdictions for tax purposes.

EU Tax Centre Comment

It is expected that the intention of the Commission to submit a report on Pillar One to the ECOFIN Council by June 2023 and assess whether a related proposal may be required will be reflected in the updated version of the compromise text once this is made publicly available.

The chair of the ECOFIN meeting, French Finance Minister Bruno Le Maire, noted that he remains optimistic that the concerns raised by Hungary can be resolved and that political agreement can nevertheless be reached before the end of the French Presidency (June 30, 2022). However, it remains to be seen whether the French Presidency of the Council can indeed facilitate political agreement on the general approach on the EU Minimum Tax Directive. Should this not be the case, it is likely that this topic will be added to the agenda of the first ECOFIN Council meeting under the Czech Presidency of the Council, which is scheduled for July 12, 2022. Bruno Le Maire noted in his closing remarks on the Minimum Tax Directive proposal discussions that a move from unanimity to qualified majority voting on key tax files would help simplify the decision-making process in the EU.

While reaching agreement on the Minimum Tax Directive remains the priority for the final days of the French Presidency of the Council, there are also a number of other pending initiatives which are

expected to be taken forward during the second half of 2022, with detailed technical work and discussions taking place on topics including:

- *Unshell Directive:* The ECOFIN report to the European Council notes that the proposal has been subject to discussions in the Council since the start of 2022 and the technical analysis of the proposal was carried out at several Council working group meetings, with a first round of article-by-article analysis being completed on May 23, 2022. In principle, most Member State delegations supported the objectives of the proposal, but it is understood that during the article-by-article examination of the proposal several issues of a technical, practical and legal nature were raised, which require further discussion in the Council before an agreement can be reached.
- *DEBRA:* The ECOFIN report to the European Council notes that the proposal was presented to the Working Party on Tax Questions on June 10, 2022. Further technical discussion are likely to follow in the second half of 2022.
- *Revision of the mandate of the Code of Conduct Group:* Based on a public exchange of views between the European Parliament's Subcommittee on Tax Matters (FISC) and the Chair of the Group on March 17, 2022, the reform of the mandate of the Group was not approved due to unresolved technical details in respect of the enlarged definition of harmful tax regimes to cover features of tax systems that have general application and that may have harmful effects. In particular, discussions focused on the link between the OECD's Pillar Two solution and those general characteristics of tax systems. It is understood that the Group will resume its work on the revised mandate with a view to advancing the reform in due time.
- *Update of the list of non-cooperative jurisdictions:* During the public exchange of views mentioned above, the Chair of the Group also noted that the CoCG held discussions on extending the geographical remit and on including additional criteria in respect of the screening of third countries. Additional criteria that were discussed include measures to ensure a minimum level of taxation in jurisdictions in line with the OECD Pillar Two solution, beneficial ownership and misuse of shell companies.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

Raluca Enache
Director
KPMG's EU
Tax Centre

Ana Puscas
Manager
KPMG's EU
Tax Centre

Cormac Golden
Associate Director
KPMG's EU
Tax Centre

Marco Dietrich
Manager
KPMG's EU
Tax Centre

kpmg.com/socialmedia

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KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands

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