Background

The revised Code of Conduct for Business Taxation

ETC Comment

ECOFIN Council agrees on revised Code of Conduct (Business Taxation)

Code of Conduct Group – Fair taxation – Harmful tax practices – Preferential tax regimes – Tax measures of general application

On November 8, 2022, the Economic and Financial Affairs Council of the EU (ECOFIN Council) agreed on a revision of the Code of Conduct for Business Taxation.

The revised Code of Conduct expands the definition of harmful tax regimes to cover features of tax systems that have general application and that may have harmful effects, provides for additional options to rollback harmful tax regimes, and strengthens the information exchange between Member States in respect of potentially harmful tax measures.

The revised Code of Conduct also clarifies the decision-making process in the Code of Conduct Group, which is responsible for the review of potentially harmful tax practices, the collaboration with the European Commission and the interplay with ongoing state aid proceedings.

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 in EU Member States. 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. The Code provided for five criteria to assess whether a tax measure is harmful:

- whether advantages are given only to non-residents or transactions with non-residents;
- whether advantages are ring-fenced from the domestic market, so that they do not affect the domestic tax base;
- whether advantages are granted even without real economic activity and substantial economic presence within the Member State offering these advantages;
- whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed in the OECD;

- whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way.

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 487 for the latest developments).

On November 26, 2021, the Group presented a proposal for a revised Code, 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 (for more details, please refer to Euro Tax Flash Issue 461).

The revised Code of Conduct for Business Taxation

On November 8, 2022, the ECOFIN Council adopted the revised Code, which closely follows the previous 2021 revision proposal and provides for the following amendments in comparison to the 1997 version of the Code:

Covered tax measures

Whereas the 1997 version only covers preferential tax regimes, the revised Code provides that tax measures of general application of a Member State may also be deemed to be potentially harmful, where they create opportunities for double non-taxation or that can lead to the double or multiple use of tax benefits. Such effects may be the result of any relevant feature of a Member State national tax system that leads to lower tax liability, including no tax liability, other than the nominal tax rate or deferred taxation stemming from a distribution tax system.

According to the revised Code, a tax feature of general application may be deemed harmful where the tax feature cumulatively meets the following criteria:

- is not accompanied by appropriate anti-abuse provisions or other adequate safeguards;
- leads to double non-taxation or allows the double or multiple use of tax benefits in connection with the same expenses, amount of income or chain of transactions; and
- affects in a significant way the location of business activity in the Union.

The revised Code further provides that when assessing a tax feature of general application, consideration should also be given to whether circumstances other than tax features may influence the business location.

Rollback options

Where a tax measure is considered to be harmful, the revised Code requires Member States to either amend the corresponding laws and practices as necessary or to adopt appropriate anti-abuse provisions or other adequate safeguards to eliminate the harmful implications of the respective tax measure.

Authorization to request information on potentially harmful tax measures

The 1997 version of the Code required Member States to notify each other of existing and proposed tax measures as well as the option for Member States to request information where a tax measure appears to fall within the scope of the Code. The revised Code now authorizes both Member States and the Commission to

bring such tax measure to the attention of the Group and to request information if a Member State has not made the respective notification to the Group.

In this case, the transmitting Member State or the Commission is required to inform the Member State concerned before raising the issue with the Group. As regards tax features of general application, the transmitting Member State or the Commission is further required to reasonably indicate why such tax feature could potentially be deemed harmful.

Assessment based on defined criteria and guidance

When assessing whether a tax measure of a Member State is harmful, the revised Code provides that the Group should generally consider the established criteria for preferential tax regimes and tax features of general application. In addition, the Group is invited to submit guidance for specific tax features of general application to the ECOFIN Council for approval to the extent that it is deemed appropriate and not already covered by EU legislation. If approved, the guidance should also be taken into account in the assessment process.

Publication of assessments

The revised Code requires the Group to regularly submit to the Council for deliberation reports on the measures assessed including the descriptions and final assessment of those measures. In addition, the revised Code requires final documents that have been approved by the ECOFIN Council to be made public, as appropriate.

Clarifications on the interaction with the European Commission and state aid proceedings

Based on revised Code, the European Commission is no longer only invited to assist the Group in carrying out the necessary preparatory work for its meetings as well as to facilitating the information exchange between Member States. The revised Code now also requires Member States to provide the Commission with the necessary information so that the Commission is enabled to prepare its own draft descriptions and assessments. However, the revised Code clarifies that the Commission does not take part in the decision-taking of the Group. Instead, the outcomes of the Group's work are to be validated by the Member State representatives at Group level and subsequently to be submitted to the ECOFIN Council for approval.

The revised Code also clarifies that where the Commission opens State aid proceedings, the Group should suspend the assessment of potentially harmful tax measures until the end of such State aid procedure.

Reference to global standards and initiatives

The revised Code requires Member States to cooperate fully in the fight against tax avoidance and evasion by exchanging information with each other in a timely manner and in accordance with national law, EU legislation and international standards. In addition, the revised Code invites the Group to discuss issues of common interest that fall within the scope of the Code and are on the agenda in international fora.

Mandate with regards to the list of non-cooperative jurisdictions

The revised Code now also includes the mandate with respect to the EU list of non-cooperative jurisdictions for tax purposes as set out in the ECOFIN Council conclusions of December 5, 2017. This requires the Group to carry out a regular assessment of relevant jurisdictions located outside of the EU in relation to their compliance with objective tax good governance principles (i.e. tax transparency, fair taxation and implementation of anti-BEPS measures).

In addition, the revised Code highlights the importance of anti-abuse provisions or defensive measures contained in national tax laws and in double taxation conventions with respect to the external strategy of the EU.

Application of the revised Code of Conduct

In general, the revised Code replaces the 1997 version as from January 1, 2023. However, an exception is provided for assessments of tax measures of general application, which will start from January 1, 2024 and only focus on measures enacted or modified on or after January 1, 2023.

ETC Comment

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 been approved in 2021 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. Examples of such general features that may be under scrutiny in the future include notional interest regimes, foreign source income regimes, depreciation rules without a recapture requirement upon disposal and tax residence provisions allowing dual non-residence.

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

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