Council of the
European Union

Brussels, 25 November 2019
(OR. en)

14114/19

FISC 444
ECOFIN 1005

REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Code of Conduct Group (Business Taxation) – Report to the Council = Endorsement

I. BACKGROUND

1. On 1 December 1997, the Council and the Representatives of the Governments of the Member States, meeting within the Council, adopted a resolution on a Code of Conduct for business taxation. This resolution provides for the establishment of a Group within the framework of the Council to assess tax measures that may fall within the Code, which was established on 9 March 1998 (doc. 6619/98). It also provides that the Group "*will report regularly on the measures assessed*" and that "*these reports will be forwarded to the Council for deliberation and, if the Council so decides, published*" (paragraph H).

2. In its conclusions of 8 December 2015 (doc. 15148/15), the Council expressed the wish to improve the visibility of the work of the Code of Conduct Group (hereafter "COCG" or "Group") and agreed "*that its results, in particular its 6-monthly reports, are systematically made available to the public*" (paragraph 16).

3. In its conclusions of 8 March 2016 (doc. 6900/16), the Council furthermore called " *for having more substantial 6-monthly Group reports to ECOFIN, reflecting the main elements and views, which were discussed under specific items and reporting also on the monitoring concerning (non-) compliance with agreed guidance*" (paragraph 16).

4. This report from the COCG encompasses the work of the Group in the second half of 2019 under the Finnish Presidency of the Council.

II. GENERAL ASPECTS

5. The COCG met four times during the Finnish Presidency of the Council: on 10 July, 13 September, 24 October and 14 November 2019. Furthermore, the Chair hosted an informal meeting of the Code of Conduct Group in Varna, Bulgaria, on 1st October 2019.

6. The COCG subgroup on internal issues met on 5 July, 4 September and 16 October 2019, whilst the subgroup on external issues met on 5 July, 4 September, 16 October and 4 November 2019.

7. At the COCG meeting of 10 July 2019, Ms. Anu Rajamäki (Finland) and Ms. Ana Marija Holzer Werft (Croatia) were confirmed respectively as the first and the second Vice-Chairs for the period up to the end of the Finnish Presidency.

8. At the same meeting, in line with its new work package, the Group approved a work programme until the end of the Finnish Presidency: see doc. 11160/2019.

III. STANDSTILL AND ROLLBACK REVIEW PROCESSES

9. A new call for standstill and rollback notifications of new preferential tax measures enacted by end 2019 was launched mid November 2019.

1. Standstill review process

10. The following decisions were reached by the Group:

- Malta's patent box (MT015) is not harmful[1]: see agreed description and final assessment in ADD 1 to the present report.

- Poland's notional interest deduction regime (PL011) is not harmful but its economic effects should be monitored. Poland furthermore indicated that targeted anti-abuse provisions would be introduced. See agreed description and final assessment in ADD 2 to the present report.

- Poland's Investment Zone regime (PL013) is harmful in respect of the preferential treatment of income of entities in the service sector: see agreed description and final assessment in ADD 3 to the present report.

11. The COCG meeting of 14 November 2019 furthermore reviewed the state of play concerning the changes to Cyprus' notional interest deduction regime (CY020). The Group was informed that the draft legislative amendments have been approved by the Cyprus government, submitted to its national parliament for adoption by end 2019 and will enter into force on 1st January 2020.

12. The standstill review of Romania's profit tax exemption for companies with innovation and R&D activities (RO008) was kept on hold until the relevant national legislation is adopted: this regime is currently not applied because the subsequent administrative acts have so far not been adopted.

[1] As in the case of almost all assessments regarding criteria 1b and 2b (assessment "?"), this is based on currently available information on statistics and the COCG reserves the possibility of reaching a potentially different outcome of a future assessment based on more complete information.

2. Rollback review process

13. At its meeting of 14 November 2019, the Group reviewed the state of play concerning the rollback of Lithuania's holding company regime (LT008). The Group was informed that the draft legislative amendments have been approved by Lithuania's government, submitted to its national parliament for adoption by end 2019 and are due to enter into force on 1st January 2021.

3. Monitoring of the actual effects of some regimes

14. At its meeting of 24 October 2019, the Group reviewed the actual effects of some measures that had been subjected to an annual monitoring. For this purpose, the Commission services had requested the three Member States concerned by the decisions adopted in 2017 to send the relevant data for the years 2016, 2017 and where available already for 2018. At its meeting of 14 November 2019, the COCG concluded that the following two measures have not affected the business location among Member States in a negative way:

- Lithuania's Special economic zones (IP component) (LT005)[2];
- Luxembourg's Intra-group financing - safe harbour rule (LU016)[3].

In respect of Italy's old intellectual property regime (IT017), it could not be analysed by the Group as Italy has so far only shared preliminary data on the use of this regime at the COCG meeting of 14 November 2019.

[2] In respect of the potential IP component, none of the companies' activities indicated in the submitted data can be attributed to computer related activities.

[3] No company has used the safe-harbour simplification rules.

IV. COCG GUIDANCE NOTES

1. Monitoring of the implementation of agreed guidance

15. The Group completed the monitoring the implementation of the 2013 COCG Guidance on intermediate (financing, licensing) companies[4].

16. Following Member States' responses to the checklist agreed by the COCG in July 2019 and a preliminary discussion at the COCG meeting of 24 October, the Commission services tabled a draft assessment of EU Member States' compliance with this guidance at the COCG meeting of 14 November 2019. The COCG concluded at this meeting that all Member States are compliant. See Annex 1 to the present report.

17. Furthermore, the COCG agreed at its meeting of 14 November 2019 on a questionnaire for monitoring the implementation of the 2016 Guidelines on the conditions and rules for the issuance of tax rulings - standard requirements for good practice by Member States[5]. The Group will continue the monitoring of the implementation of this guidance during the incoming Croatian Presidency.

2. Guidance on notional interest deduction regimes

18. The COCG subgroup on internal issues discussed the draft guidance at its meeting of 5 July 2019 and found an agreement on a final text at its meeting on 16 October 2019: see Annex 2 to the present report. The COCG endorsed this agreement at its meeting of 24 October 2019.

19. This guidance on notional interest deduction regimes is aimed at assisting Member States that would wish to implement a similar regime to those already assessed as not harmful by the Group (BE018, IT019, MT014, PT018 and PL011).

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4 See updated compilation of COCG agreed guidance in doc. 5814/5/18, pages 27-28.
5 See updated compilation of COCG agreed guidance in doc. 5814/5/18, pages 80-83.

20. The Group has also started using this guidance for the assessment of third country jurisdictions' similar regimes. Switzerland's notional interest deduction regime (CH007) was first examined by the subgroup on external issues at its meeting of 4 November 2019.

V. THE EU LIST OF NON COOPERATIVE JURISDICTIONS FOR TAX PURPOSES

1. Delisting of certain jurisdictions

21. Recalling paragraph 11 of the Council conclusions of 5 December 2017, the Council conclusions of 12 March 2019 confirmed that the Code of Conduct Group "*should recommend to the Council to update at any time, and at least once a year, the EU list set out in Annex I as well as the state of play set out in Annex II on the basis of any new commitment taken or of the implementation thereof; but, as from 2020 onwards, such updates of the EU list should be done no more than twice a year, leaving sufficient time, where appropriate, for Member States to amend their domestic legislation*" (paragraph 16), thereby agreeing to keep a dynamic process throughout 2019.

22. The EU list of non-cooperative jurisdictions for tax purposes was subsequently modified by the ECOFIN Council on 17 May 2019[6] and 14 June 2019[7], with the de-listing of Aruba, Barbados, Bermuda and Dominica. Further updates to Annexes I and II of the Council conclusions of 12 March 2019 were also made on the same occasion.

[6] OJ C 176 2019 pages 2-5.
[7] OJ C 210 2019 pages 8-11.

23. Since then, the Marshall Islands adopted on 15 August 2019 an amendment to its Economic Substance Regulation, 2018 thereby resolving the EU's last area of concern[8], i.e. the issue of evidencing tax residence in another jurisdiction, which created a significant risk of circumvention of the substance requirements and related information exchange.

The COCG subgroup on external issues examined this amendment at its meeting of 4 September 2019 and concluded that the Marshall Islands had now fully implemented its commitment to introduce substance requirements under criterion 2.2 and could therefore be removed from Annex I (delisting). Considering that the Marshall Islands' review by the Global Forum was still ongoing, the subgroup also concluded that the Marshall Islands should however remain in section 1.2 of Annex II (exchange of information on request) pending the result of this review. The COCG confirmed these conclusions at its meeting of 13 September 2019 and the ECOFIN Council subsequently approved the delisting of the Marshall Islands at its meeting of 10 October 2019[9].

[8] The Marshall Islands had adopted on 21 February 2019 earlier amendments to its Economic Substance Regulations, 2018 but these were not deemed sufficient by the COCG considering this last area of concern and for this reason the Marshall Islands was listed on Annex I by the ECOFIN Council on 12 March 2019.

[9] See outcome of proceedings: doc. 13049/19

24. The United Arab Emirates (UAE) adopted on 30 April 2019 its Economic Substance Regulation. This Regulation reflected most of the feedback that it had received from the COCG but introduced a general exemption for all entities in which the UAE government, or any of the Emirates of the UAE, had direct or indirect ownership (no threshold) in its share capital. The COCG meeting of 20 May 2019 considered that this created a signifiant risk of circumvention of the substance requirements and concluded that the UAE was still not compliant with criterion 2.2. However, since then the UAE adopted on 1st September 2019 an amendment that introduced a threshold of 51% government ownership (direct or indirect) of share capital.

The COCG subgroup on external issues examined the above draft legislative amendment at its meeting of 4 September 2019 and concluded that, if adopted, it would resolve EU's concerns. The COCG at its meeting of 13 September subsequently received the confirmation of the adoption of the above-mentioned amendment, and concluded that the UAE had now fully implemented its commitment to introduce substance requirements under criterion 2.2 and could therefore be removed from Annex I (delisting). The ECOFIN Council subsequently approved the delisting of the UAE at its meeting of 10 October 2019[10].

25. Belize has adopted on 11 October 2019 a reform of its International Business Companies - IBC regime (BZ001). The relevant legislative acts were gazetted on 12 October 2019.

The COCG subgroup on external issues had examined a draft version of the above legislative acts at its meeting of 16 October 2019 and concluded that, if the reform was adopted, the new IBC regime (as amended) could be considered as not harmful. The COCG subsequently received the confirmation of its adoption and concluded at its meeting of 24 October 2019 that Belize had met its commitment to amend its IBC regime. The ECOFIN Council subsequently agreed at its meeting of 8 November 2019 that Belize is delisted from Annex I[11] and added to section 2.1 of Annex II pending implementation of its commitment to amend or abolish the harmful features of its foreign source income exemption regime (BZ006).

[10] See outcome of proceedings: doc. 13047/19
[11] See outcome of proceedings: doc. 14204/19

26. As a result, 8 jurisdictions remain as of today in the EU list of non-cooperative jurisdictions for tax purposes: American Samoa, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, the US Virgin Islands and Vanuatu. The COCG Chair had exchanges with representatives of Samoa, Trinidad and Tobago and Vanuatu, who reiterated their commitment to cooperate with the EU and confirmed that efforts are underway to meet EU's tax good governance criteria.

2. Monitoring the implementation of commitments taken by jurisdictions

General overview

27. As of 14 November 2019, the implementation of a total of 46 commitments[12] taken at high political level by 36 jurisdictions (5 in Annex I[13], 31 in Annex II) remain to be monitored by the Group:

Criterion	Number of jurisdictions committed
1.1	3
1.2	7
1.3	14
2.1	13
2.2	6
3.1	3[14]

Most of these commitments are due to be implemented by the end 2019.

[12] This figure adds up the number of jurisdictions committed under each criterion (see table).

[13] Fiji, Oman, Samoa, Trinidad and Tobago and Vanuatu. Note: the commitments Oman (criteria 1.1 and 1.3), Samoa (criterion 3.1) and Vanuatu (criterion 2.2) were due to be fulfilled by end 2018 but these commitments were not met.

[14] Does not include the 3 jurisdictions (Nauru, Niue and Palau) that are committed to become member of the Inclusive Framework on BEPS or implement OECD anti-BEPS minimum standards "*if and when such commitment will become relevant*".

28. As of 14 November 2019, a total of 22 harmful tax regimes[15] remained to be rolled back under criterion 2.1, 20 of which are under monitoring by the COCG[16] and 2 by the OECD FHTP[17]. A detailed overview may be found in the updated compilation of preferential regimes examined by the COCG since its creation in March 1998[18].

29. This process of monitoring commitments continues in line with the procedural guidelines approved by the COCG in February 2018[19].

Updates of Annex II

30. As a result of this monitoring process, a number of updates of Annex II were endorsed by the ECOFIN Council at its meetings of 10 October, 8 November and 5 December 2019:

31. Namibia and Jordan having joined on 26 August and 29 October 2019 the Global Forum on transparency and exchange of information for tax purposes (hereafter "GF"), the COCG meetings of 13 September and 14 November 2019 agreed that they should be removed from section 1.2 of Annex II.

32. Morocco, the Republic of North Macedonia and Serbia having ratified, respectively on 22 May, 30 September and 30 August 2019, the OECD Multilateral Convention on Mutual Administrative Assistance ("MAC") as amended, the COCG meeting of 13 September 2019 agreed that they should be removed from section 1.3 of Annex II.

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15 These figures don't include the harmful tax regimes of the US Virgin Islands (3) and Samoa (1), for which no sufficient high-level commitments to be monitored have been received yet.

16 Regimes AG003, BZ006, CK001, CK002, CK004, CK006, CW005, CW006, FJ001, FJ002, FJ003, KN002, LC005, MA006, MV001, NA001, NA002, SC010, SC011, and TT001.

17 Regimes AU001 and JO002.

18 Doc. 9639/3/18 REV 4 (it will be issued in December 2019).

19 Doc. 6213/18

33. Costa Rica adopted on 15 May 2019 legislative amendments to its Free Zones regime (CR001). These were reviewed by the OECD Forum on Harmful Tax Practices (FHTP) at its 19-21 June 2019 meeting, which concluded that they are not harmful. The COCG endorsed this conclusion at its meeting of 10 July 2019. Considering that these legislative amendments also addressed the manufacturing activities falling under the free zones regime (CR002), the COCG concluded at its meeting of 13 September 2019 that Costa Rica had fully implemented its commitment to remove the harmful features of its Free Zones regime and should therefore be removed from section 2.1 of Annex II[20].

34. Mauritius adopted on 25 July 2019 its Finance Bill 2019 and on 16 August 2019 additional regulations that amended the legislation applicable to its Freeport zone (MU012) and Partial Exemption (MU010) regimes.

The COCG meeting of 13 September 2019 examined these amendments and concluded that Mauritius had met its commitment to address the deficiencies identified in these two regimes: whilst the Freeport zone regime is no longer preferential, adequate substance requirements have been introduced in both regimes and the issue of lack of anti-abuse rules has been addressed. As a result, the COCG concluded that Mauritius should therefore be removed from section 2.1 of Annex II[21].

[20] See outcome of proceedings: doc. 13207/19
[21] See outcomes of proceedings: docs. 13208 and 13209/19

35. Switzerland adopted its tax reform in October 2018 but the entry into force and entry into application of the legislation were postponed pending the outcome of the referendum in May 2019 and for this reason Switzerland was granted an additional year to comply with criterion 2.1 "*due to genuine institutional or constitutional issues despite tangible progress in 2018*". Following the positive outcome of this referendum, Switzerland informed the COCG in August 2019 that the official results had been published in the Official Gazette. As a result, the relevant legislation entered into force on 16 July 2019 and will enter into application on 1st January 2020, whilst Switzerland had already announced that its federal regimes CH004 and CH005 had been closed to new entrants as from 1st January 2019.

The COCG meeting of 13 September 2019 reviewed the situation and concluded that Switzerland should therefore be removed from section 2.1 of Annex II on the basis that the necessary reforms had been adopted and gazetted[22].

36. The COCG meeting of 13 September 2019 also agreed that the deadline of Namibia for complying with criterion 2.1 should be changed from 9 November to end 2019, which requires an amendment to Annex II. The objective was to align the deadline with that of other criteria and jurisdictions and respect national budgetary cycles.

37. Furthermore, Albania, Bosnia and Herzegovina, Eswatini, Jordan and Namibia having joined the Inclusive Framework on BEPS respectively on 8 August, 11 July, 26 July, 29 October and 9 August 2019, the Code of Conduct Group agreed on 13 September and 14 November 2019 that they should be removed from section 3.1 of Annex II.

38. As a result, Albania, Costa Rica, Mauritius, the Republic of North Macedonia, Serbia and Switzerland were removed entirely from Annex II.

[22] See outcomes of proceedings: docs. 13196-13202-13203-13205 and 13206/19

Procedural and political aspects of the monitoring process

39. A number of procedural issues had to be resolved by the Group since June 2019, notably:

- End of the general "two out of three" exception for tax transparency criteria (1.1, 1.2 and 1.3) at the end of June 2019: the COCG concluded that all jurisdictions concerned met EU requirements. In particular:

  – Following the mandate received from the COCG, the Chair initiated an extensive dialogue with the US Treasury in respect of EU criterion 1.3[23] which concluded that the EOIR that has taken place to date between Croatia and the USA is effective and satisfactory by both sides. Furthermore, the Minister of Finance of Croatia received on 3 September 2019 an official letter from the US Treasury that stated that it would continue to exchange tax information with Croatia in line with international standards and the respective needs of both sides. As a result, the COCG meeting of 13 September 2019 concluded that the USA can be considered to fulfil the conditions to meet criterion 1.3.

  – Niue adopted the necessary legislation to implement the Common Reporting Standard (CRS) and activated AEOI bilateral exchange relationships with all relevant Member States by 2nd September 2019. On this basis, the COCG concluded that Niue is compliant with criterion 1.1.

  – Other jurisdictions identified by the COCG as possibly affected by the end of the "two out of three" exception for tax transparency criteria (notably Vanuatu and Israel) had already complied at an earlier stage by activating AEOI bilateral exchange relationships with all EU Member States (except Cyprus and Romania for the time being, due to their non-reciprocal status for CRS).

[23] The USA were already deemed to meet EU criteria 1.1 and 1.2 in December 2017.

- Coordination with FHTP on criterion 2.2: Following the mandate received from the COCG, the Chair also initiated a dialogue with the OECD FHTP on a possible alignment of its new standard on no/only nominal tax jurisdictions (approved by the Inclusive Framework end 2018) and EU's criterion 2.2 with a view to establishing a single global standard in this field. Following a meeting with the OECD FHTP Co-Chair and secretariat in June 2019, the COCG meeting of 10 July 2019 concluded that:

  – In respect of high-risk IP cases, the COCG will maintain the EU standard for high-risk IPs for now, given that the FHTP has agreed to integrate the additional EU elements into the exchange of information documentation;

  – The COCG will review the situation after the first exchanges by 2.2 jurisdictions, to see if the two parallel standards pose any problems for the jurisdictions concerned;

  – Collective investment funds (CIVs) will remain an area of divergence between the EU and FHTP standards.

- Assessment of compliance: At the COCG meeting of 10 July 2019, the question arose as to whether a jurisdiction has fulfilled its commitment upon adoption of the required legislation, or only once this has entered into application. The COCG meeting of 13 September 2019 concluded that:

  – For 2.1 jurisdictions, final assessment is triggered by adoption and entry into force (publication in the gazette) of the legislation.

  – Where there is a notable gap between adoption/entry into force and the entry into application, this should be considered in the final assessment, to ensure that there are no risks of continued harmful effects.

  – For 2.2 jurisdictions, the required entry into application date has been 1/1/2019 for jurisdictions with commitments for 2018. This should be applied retroactively to legislation adopted by these jurisdictions after that date.

- New GF ratings for criterion 1.2: The COCG agreed on an approach for jurisdictions that receive a new rating of the Global Forum on transparency and exchange of information (the Global Forum) under Round two of its Peer Review process. At its meetings of 24 October and 14 November, the situation of jurisdictions that receive a more negative rating from the Global Forum than they previously had was discussed. In this respect the COCG agreed that:

  – Developing countries without a financial centre that are downgraded to 'Partially Compliant' would need to address the identified deficiencies and request a supplementary review to achieve a new rating;

  – Jurisdictions eligible should commit at a high political level to request a supplementary review from the GF within 18 months of the date of their commitment. If the commitment is assessed as sufficient by COCG, the jurisdictions in question should remain on Annex II, pending the outcome of the supplementary review.

  – The above approach would not apply to jurisdictions which received a 'non-compliant' GF rating.

  – With respect to other jurisdictions, i.e. developed countries and developing countries with a financial centre, they will be included in Annex I when the new negative rating is confirmed by the GF. A jurisdiction could only be delisted from Annex I and included in Annex II once they have been granted a supplementary review by the GF. They would subsequently remain on Annex II pending the outcome of this supplementary review.

    It was noted in this regard that the granting of such supplementary review is only possible once the jurisdiction in question has taken sufficient steps to improve its overall rating or to address the deficient essential element.

- Grandfathering under criterion 2.1: following a request sent by Cook Islands to the Chair, the COCG meeting of 13 September 2019 agreed to extend its grandfathering deadline by one year considering the one-year deadline extension which it had received in March 2019 in consideration for its genuine institutional/constitutional issues.

- Legislative changes in jurisdictions under criterion 2.2: Certain criterion 2.2 jurisdictions have sought to adjust their economic substance legislation and/or guidance - which had already been cleared by the COCG - in order to align with their main competitors. The COCG recognized that this creates a risk of "backtracking" by these jurisdictions under criterion 2.2. Against this background, the COCG meeting of 24 October 2019 agreed that jurisdictions should be encouraged to notify planned changes (to the legislative framework or related guidance) to the COCG before their adoption:

  – if a jurisdiction does notify the COCG, it would be granted a maximum of 3 months to address any possible concern raised by the COCG after the adoption of the said changes before a listing recommendation is made to the ECOFIN Council;

  – in the contrary case (no prior notification) and provided that these changes are deemed to be harmful by the Group, the jurisdiction in question would be informed that it is recommended for inclusion in the EU list of non cooperative jurisdictions to the ECOFIN Council.

- Exchange of information with criterion 2.2 jurisdictions: the COCG took note at its meeting of 14 November 2019 of a means to have a common approach for activating exchange of information with criterion 2.2 jurisdictions. This would entail opting-in to the OECD FHTP Standardised Format and referring to particular EU legislation (Anti tax avoidance directive - ATAD) and international standards (CRS) when indicating the "foreseeable relevance" of the information to be exchanged.

- National defensive measures: following a request sent by Liechtenstein to the Chair, the COCG stressed that issues related to national defensive measures should be followed up in bilateral contacts by the Member States concerned considering that they go beyond the mandate received by the COCG[24] from the ECOFIN Council.

- Transparency issues: the COCG meeting of 13 September 2019 agreed to systematically ask for the jurisdictions' consent to publish their commitment letters when seeking commitments to amend/abolish newly identified harmful measures: such consent had until now only been sought in specific cases.

40. The COCG also discussed the possibility of additional flexibility for developing countries without a financial centre under criterion 1.3, as well as the possibility of aligning on the OECD FHTP timelines in respect of assessments and grandfathering, but deferred its recommendation to the ECOFIN Council on these issues to the beginning of 2020.

41. Furthermore, the COCG Chair received a number of letters from jurisdictions and also held meetings or telephone conferences at political level with a number of them. The Chair also met in particular with several representatives of the ACP Group in Brussels on 23 October 2019. Delegations were kept informed about these interactions, and in some cases response letters signed by the Chair were agreed by the Group.

[24] Except in relation to the jurisdictions included in the EU list of non-cooperative jurisdictions for tax purposes (see Council conclusions of 5 December 2017, doc. 15429/17, paragraph 18) and to Switzerland (see the 2014 Joint EU/Switzerland Statement, doc. 6972/18 ADD 43, section 4).

3. Identification of new tax measures under criteria 2.1 and 2.2

Identification of new preferential regimes under criterion 2.1

42. The following 24 new preferential regimes were identified by the COCG since the last 6-month progress report under criterion 2.1:

- AW014: Exempt companies[25] (under FHTP monitoring);
- AW015: Investment Promotion regime (under FHTP monitoring);
- BW002: foreign source income exemption regime (under COCG monitoring);
- CH006: patent box of the Canton of Nidwalden (under FHTP monitoring);
- CH007: Notional interest deduction (NID) regime (under COCG monitoring);
- CH008: intellectual property (IP) box (under FHTP monitoring);
- CR003: foreign source income exemption regime (under COCG monitoring);
- CV004: incentives for internationalisation (under COCG monitoring);
- HK009: foreign source income exemption regime (under COCG monitoring);
- MK001: Technological industrial development zone (under FHTP monitoring);
- MU013: IP regime (under FHTP monitoring);
- MV002: foreign source income exemption regime (under COCG monitoring);
- MY015: foreign source income exemption regime (under COCG monitoring);
- NA003: foreign source income exemption regime (under COCG monitoring);
- NR001: foreign source income exemption regime (under COCG monitoring);

[25] Revision of the AW002 regime

- PA008: foreign source income exemption regime (under COCG monitoring);
- QA002: Qatar financial centre - QFC (under FHTP monitoring);
- QA003: Free zone areas (under FHTP monitoring);
- QA004: foreign source income exemption regime (under COCG monitoring);
- SG013: foreign source income exemption regime (under COCG monitoring);
- SZ002: foreign source income exemption regime (under COCG monitoring);
- TH006: International business centre (IBC) (under FHTP monitoring);
- UY008: foreign source income exemption regime (under COCG monitoring);
- WS002: foreign source income exemption regime (under COCG monitoring).

43. Furthermore, the COCG noted that it had identified by mistake 3 new regimes in the Cook Islands in April 2019. These 3 regimes[26] were therefore removed from the COCG compilation set out in doc. doc. 9639/4/18.

[26] Patent box, Holding company regime, and Strategic industries incentives.

Assessment of newly identified preferential regimes under criterion 2.1

44. The following assessments were furthermore agreed by the COCG in respect of the new preferential regimes that fall under its monitoring:

- Belize's Fiscal Incentives Act (BZ003) is not harmful: see ADD 4;
- Belize's General Income Tax Act section 14 (BZ004) does not need to be assessed: see ADD 5;
- Belize's Free zones Act (BZ005) is not harmful: see ADD 6;
- Cabo Verde's Incentives for Internationalisation (CV004) is not currently harmful: see ADD 7;
- Eswatini's Special economic zones (SZ001) is not yet operational;
- Mongolia's Remote areas regime[27] (MN002) is not harmful: see ADD 8;
- Vietnam's Economic zones regime (VN004) is not harmful: see ADD 9; and
- Vietnam's Disadvantaged areas regime (VN005) is not harmful: see ADD 10.

45. With regard to the other regimes falling under FHTP monitoring, the COCG endorsed the following assessments :

- Cabo Verde's shipping regime (CV003) is not harmful;
- Mauritius' patent box (MU013) is not harmful;
- Mongolia's Free trade zone regime (MN001) has been abolished;
- Switzerland's patent box of the Canton of Nidwalden (CH006) is not harmful; and
- Thailand's International business centre regime (TH006) is not harmful.

[27] 90% tax credit regime for companies residing in isolated province (500 km)

Identification of new measures under criterion 2.2

46. Since the March 2019 ECOFIN, a number of the jurisdictions covered under criterion 2.2 have informed the COCG about (planned) changes to their regulatory framework. For traceability and transparency purposes, the COCG therefore agreed that it would be useful to attribute a code to each of these new measures, as is done for regimes under criterion 2.1 and publish outcomes of proceedings for each measure once the final legislation/guidance has been cleared by COCG and ECOFIN (as done recently for the Cayman Islands).

47. At the same time, some of these jurisdictions already had preferential regimes identified with codes under criterion 2.1, before that they moved to a criterion 2.2 situation. In these cases, the codes could follow the last one identified under criterion 2.1.

48. The following 8 new measures[28] were identified by the COCG since the last 6-month progress report under criterion 2.2:

- Bahrain: BH002 (new guidance);
- Bermuda: BM003 (legislative amendments + new guidance);
- British Virgin Islands: VG007 (new guidance);
- Cayman Islands: KY003 (legislative amendments);
- Guernsey: GG010 (new guidance);
- Isle of Man: IM016 (new guidance);
- Jersey: JE007 (new guidance);
- Turks and Caicos Islands: TC003 (legislative amendments);
- UAE: AE003 (new guidance).

[28] The measures under criterion 2.2 already identified in 2017-2018 are not listed here but can be found in the updated COCG compilation.

49. In respect of the legislative changes that occurred in the Cayman Islands (KY003), these amendments were examined by the COCG meeting of 20 May 2019 and COCG subgroup meetings of 5 July and 4 September 2019, which expressed concerns that the Cayman Islands introduced features that could be considered as not compliant with EU requirements.

Further legislative changes, gazetted on 10 September 2019[29], were examined by the COCG meeting of 13 September, at which the Group concluded that the Cayman Islands remains compliant with EU criterion 2.2 (except for what concerns collective investment funds[30]). This conclusion was endorsed by the ECOFIN Council at its meeting of 10 October 2019[31].

4. Screening and scoping issues

Screening process

50. As requested by the Group, the Commission services started the screening of Argentina, Mexico and Russia against the agreed EU listing criteria in the first semester of 2019.

51. The subgroup on external issues was regularly updated on the progress of this screening process and a final technical report on each of these jurisdictions was submitted to the COCG at the beginning of November 2019. However, further discussions will be needed on this issue at the beginning of 2020.

[29] http://www.gov.ky/portal/pls/portal/docs/1/12852496.PDF

[30] The Cayman Islands committed to addressing the concerns relating to economic substance in the area of collective investment funds and adapt its legislation by end 2019.

[31] See outcome of proceedings: doc. 7222/19 ADD 1.

Foreign source income exemption regimes

52. The COCG, at its meeting of 13 September 2019, consolidated in a new guidance its approach on foreign source income exemption regimes[32], which was endorsed by the ECOFIN Council on 10 October 2019 (doc. 12284/1/19). This guidance is aimed at providing direction for the jurisdictions[33] that have already taken a commitment to amend their foreign source income exemptions, due to harmful features identified by the COCG at the beginning of 2019[34]. It acknowledges foreign source income exemption regimes as a legitimate approach to prevent double taxation, but at the same time identifies potentially harmful elements which could be present in such regimes. Such elements can result in double non-taxation.

53. This guidance also served as a basis for the preliminary screening of other jurisdictions with similar regimes. The Commission services presented the result of this screening to the subgroup on external issues on 16 October 2019 and these results were subsequently also discussed at the COCG meeting of 24 October 2019.

54. As a follow-up, the COCG meeting of 14 November 2019 agreed to recommend the ECOFIN Council of 5 December 2019 to start the assessment of the newly identified foreign source income exemption regimes listed above (see paragraph 42). This assessment will initially focus on the nine jurisdictions that are either developed countries or developing countries with a financial centre, in order to assess whether the regimes concerned contain harmful elements. These nine jurisdictions have previously been assessed on specific regimes, but not on these foreign source income exemption rules.

55. Regarding the foreign source income exemption regimes that have been identified in four developing countries without a financial centre[35], the COCG agreed to engage in a dialogue on this matter with the jurisdictions concerned and assess these regimes in a second stage.

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32 See updated compilation of COCG agreed guidance in doc. 5814/5/18, pages 154-157.
33 Belize, Curaçao, Saint Lucia and Seychelles have pending commitments regarding such regimes.
34 See doc. 5981/19.
35 BW002, MV002, NA003 and SZ002.

Exemption of developing countries without a financial centre from criterion 1.1

56. The COCG meeting of 24 October 2019 agreed that developing countries without a financial centre should continue to be exempt from EU criterion 1.1, including those which have decided to implement AEOI on a voluntary basis.

57. The COCG agreed at the same time that, if a developing country without a financial centre is identified as a jurisdiction of relevance by the GF, it should nevertheless be considered for the application of criterion 1.1. The COCG will follow the timeline of the Global Forum in order for a jurisdiction to implement the standard.

Future criterion 1.1 (AEOI ratings)

58. The COCG meeting of 24 October 2019 agreed to wait for the availability of GF ratings on AEOI before starting to apply future criterion 1.1 (as set out in the Council conclusions of 8 November 2016).

Future criterion 1.4 (beneficial ownership)

59. The EU listing criteria approved by the ECOFIN Council in November 2016 (doc. 14166/16) included the following reference: "*1.4 Future criterion: in view of the initiative for future global exchange of beneficial ownership information, the aspect of beneficial ownership will be incorporated at a later stage as a fourth transparency criterion for screening*".

60. Discussions on this future criterion took place in the subgroup on third countries meetings of 18 and 25 January 2019 but were subsequently put on hold due to questions related to ongoing discussions on possible changes to the peer review methodology under the new mandate of the GF.

61. At its meeting of 24 October 2019, the COCG agreed to resume discussions at subgroup level at the beginning of 2020 on criterion 1.4.

62. These discussions will also consider whether standalone beneficial ownership transparency requirements should be established under criterion 2.2 or whether a comprehensive approach could be found under future criterion 1.4.

Follow-up scoping issues under criterion 2.2

63. In respect of mandatory disclosure rules, the COCG meeting of 24 October 2019 agreed to explore the feasibility of aligning with the OECD FHTP work in this area.

64. With regard to the treatment of partnerships, the COCG agreed at its meeting of 14 November 2019 on an activity-based approach as well as on a set of questions to be sent to the relevant jurisdictions, to identify partnerships that would fall under the economic substance requirements of criterion 2.2. See Annex 3 to the present report.

5. Further coordination of defensive measures in the tax area towards non-cooperative jurisdictions

65. The COCG continued its work on further co-ordination of defensive measures, as it has been requested by ECOFIN Council, in its Conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes of 12 March 2019, "*to finalise discussions on further coordinated defensive measures, without prejudice to Member States' obligations under EU and international law*"[36]. This request was also reiterated by the Council in its 14 June 2019 conclusions[37].

66. During the term of the Finnish Presidency, discussions on further coordinated defensive measures resumed in July 2019 at the COCG and its subgroup on external issues.

[36] Council conclusions of 12 March 2019, point 20, doc. 7441/19.
[37] Council conclusions of 14 June 2019, point 16, doc. 10340/19.

67. At its meeting of 14 November 2019, the COCG reached agreement on a 'Guidance on defensive measures in the tax area towards non-cooperative jurisdictions', which is set out in Annex 4 to this report. COCG also took note that some Member States that, due to the nature and content of defensive measure and the national rules on enactment of laws, might face genuine institutional or constitutional issues that prevent them from meeting the deadline referred to in point 25 of that Guidance should ensure that this commitment is fulfilled by 1 July 2021.

ANNEX 1

Compliance of EU Member States with the

COCG Guidance on intermediate (financing, licensing) companies

	Assessment	**Particular scrutiny by the Group**	**Monitoring of the results**
Austria	Compliant		
Belgium	Compliant		
Bulgaria	Compliant		
Cyprus	Compliant	Done	Annual monitoring
Czech Republic	Compliant		
Germany	Compliant		
Denmark	Compliant		
Estonia	Compliant		
Greece	Compliant		
Spain	Compliant		
Finland	Compliant		
France	Compliant		
Croatia	Compliant		
Hungary	Compliant		
Ireland	Compliant		
Italy	Compliant		

Latvia	Compliant		
Lithuania	Compliant		
Luxembourg	Compliant	Don: see LU016	Annual monitoring ongoing
Malta	Compliant		
Netherlands	Compliant		
Poland	Compliant	Done: commitment to spontaneously exchange information	Annual monitoring
Portugal	Compliant		
Romania	Compliant		
Sweden	Compliant		
Slovenia	Compliant		
Slovak Republic	Compliant		
United Kingdom	Compliant		

Explanation:

a) Luxembourg rules

The aspect raising potential concern regarding the rules on intra-group financing activities relates to the application of the safe-harbour of 2% net return on financial assets. However, this specificity was looked into by the Group when it was introduced in 2017 (LU016). The Group decided that the Luxembourg measure did not need to be assessed as it did not seem to entail any risk in the light of the Code of Conduct criteria, but that a monitoring should take place. Luxembourg committed to spontaneously exchange information in certain specific instances[38]. This falls within the scope of the annual monitoring and the assessment of the actual effects of the safe-harbour rule is done within that exercise.

b) Polish rules:

Beginning 2019, the Polish authorities introduced two safe-harbours in the area of transfer pricing (for low value-adding services and for certain loans transactions). The safe harbour for certain related party small loan transactions (up to 20 000 000 PLN, i.e. around EUR 5 000 000, of total indebtedness) enables the taxpayer to reduce its TP documentation requirements by applying the pre-determined interest rate. The loans should not be granted for more than five years. The interest rate is based on the *base interest rate* plus a *margin announced* by the Minister of Finance. The parameters are announced periodically by the Minister of Finance, not less frequently than once a year. For 2019 the Notice of the MF states that the base interest rate is represented by 3 months interest rate for loans in different currencies, while the margin for all above mentioned currencies is set at the level of 2% per year (which is the maximum margin for the borrower and the minimum for the lender). These parameters are monitored and updated periodically**.**

[38] Luxembourg committed to spontaneously exchange information:
"- in the instances provided by the circular (i.e. when the taxpayer makes use of the safe harbour rule), and
- also in instances where a taxpayer would apply the 2% net return on financial assets in his commercial accounts and would then apply, based on a transfer pricing analysis, a downward adjustment in the tax return in order to achieve an at arm's length remuneration."

The measure referred to under point a) is a straightforward precedent adopted by the Group. The Commission Services have thus asked the Polish authorities whether similar spontaneous exchange of information takes place.

The Polish authorities replied on 7 November 2019 that the information concerning the taxpayers benefiting from Polish safe harbour rules is collected and will be automatically reported under the EU Directive 2018/822 (DAC 6).[39] According to the Polish authorities, the reporting based on Mandatory Disclosure Rules (MDR) is sufficient and there is no justification for re-sending the information on a spontaneous basis. The first automatic exchange on MDR will take place in 2020.

In light of the aforementioned explanations, we are of the view that three aspects are not fully compliant with the precedent set by the Group:

- first, Directive 2018/822 requires an arrangement. It is unclear whether the use of a safe-harbour rule in all cases constitutes an arrangement under Directive 2018/822;
- second, the exchange of information in Directive 2018/822 is different: the use of the safe-harbour rule is an information which is directly available to the tax administration, as it is mentioned in the tax return. Therefore, this information can be directly exchanged with the Member State concerned. Under the Directive the exchange would be dependent on an intermediary transferring such information to the Polish tax administration and afterwards the Polish tax administration would upload the information in the central directory on administrative cooperation. The Member State concerned would not receive the information directly;
- third, the *instances where a taxpayer would apply the safe-harbour in his commercial accounts and would then apply, based on a transfer pricing analysis, a downward adjustment in the tax return in order to achieve an at arm's length remuneration* are not addressed at all.

[39] According to Poland, the evaluation of the Luxembourg's system, indicated by the Commission as a comparable example, was carried out even before the implementation of MDR. Thus, at that time, the exchange of this information could take place on a spontaneous basis.

During the COCG meeting of 14 November 2019, the Polish authorities committed to spontaneously exchange information ensuring therefore that the (other) Member States concerned receives directly the relevant information.

In light of the aforementioned commitment, the COCG considered the Polish safe-harbour rule to be compliant with the 2013 Guidance. However, as for the Luxembourg measure, the Group will further monitor the actual effects of the measure/ the use of the safe-harbour rule.

c) Cypriot rules:

In 2017 Cyprus published a Circulaire which explains how to apply the arm's length principle to intragroup financing transactions. It also provides for a simplified measure – safe-harbour rule – that applies in the case of a purely intermediary entity providing financing (i.e. where an entity provides loans to a related entity and these loans are funded by loans received from other related entities). In this instance, the Circulaire allows that the intermediary financing entity may receive a minimum return of 2% net profit on assets. This percentage is regularly reviewed by the Tax Department based on relevant market analyses. In order to use the simplified measures, the concerned entity must notify the tax authority accordingly in its tax return. The taxpayer is not allowed to derogate from the minimum percentage, unless this is properly justified in transfer pricing analysis.

The measure referred to under point a) is a straightforward precedent adopted by the Group. The Commission Services have thus asked the Cypriot authorities whether similar spontaneous exchange of information takes place. The Cypriot authorities confirmed that spontaneous exchange of information takes place *when the taxpayer makes use of the safe harbour rule.*

Further clarification has been asked whether similar exchange of information is provided for *also in instances where a taxpayer would apply the safe-harbour in his commercial accounts and would then apply, based on a transfer pricing analysis, a downward adjustment in the tax return in order to achieve an at arm's length remuneration.* The Cypriot authorities explained that the decision of a company to make use of the simplification measures in a tax year is declared on the tax return[40] of the respective tax year and it is not communicated to the Tax Department at any point of time before[41]. Therefore, if a company, at the time of the submission of its tax return has made use of the simplification measures, it will tick the relevant box, and such information will be exchanged spontaneously; otherwise, in case it has applied a different return based on a transfer pricing study, the relevant box will not be ticked and no exchange of information will take place.

As the relevant spontaneous exchange of information takes place when the taxpayers makes use of the safe-harbour, the COCG considers the measure to be compliant with the Guidance. However, as for the Luxembourg measure, the Group will further monitor the actual effects of the measure/ the use of the safe-harbour rule.

[40] It is noted that following the issuance of the circular "Tax treatment of intra-group back-to-back financing arrangements" the company's tax return was amended so as to incorporate a tick box, in which the taxpayer specifies whether it has made use of the simplification measures.

[41] Except in the case that the Company has applied for a tax ruling.

Guidance on notional interest deduction regimes

1. Purpose of the Guidance

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 of Conduct Group's work. It is also intended to help Member States as well as third countries identify more easily potentially harmful tax measures.

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 Notional Interest Deduction Regime may be harmful when assessed against the criteria of the Code of Conduct. Every assessment will continue to be based on the five criteria of the Code of Conduct on a case-by-case approach.

The purpose of the text is to provide guidance on the application of the criteria of the Code of Conduct 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 Notional Interest Deduction Regime that requires particular attention under the guidance may be found not harmful by the Code of Conduct Group; likewise a measure that does not require particular attention under the guidance may be found to be harmful when assessed by the Group.

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 of Conduct criteria in the light of the Group's guiding principles set out in document 16410/08 FISC 174.

2. Relationship with past assessments

Past assessments will not be affected by the guidance. Regimes that have not been considered by the Group can be reviewed on the basis of this guidance and the criteria of the Code of Conduct. The current procedure for reopening past assessments remains valid.

3. Review of the guidance

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

4. Guidance

4.1 General methodology of the assessments

The NID regimes are not based on a special income generated or a special activity performed but on the policy goal to tackle the debt bias.

Such a regime should have certain limitations in scope and be properly contained by appropriate anti-abuse measures in order to tackle tax-planning opportunities.

Paragraph L of the Code of Conduct states that: "anti-abuse provisions or countermeasures contained in tax laws and in double taxation conventions play a fundamental role in counteracting tax avoidance and evasion". In past assessments, the Code of Conduct Group has taken into account under criterion 3, the existence of limitations in the scope and appropriate anti-abuse provisions or countermeasures. In order to avoid tax planning and address abusive situations in applying NID regimes, the below enumerated limitations of the scope and anti-abuse measures have been identified.

4.2 Proportionality

As the NID regimes may differ significantly with regard to the base (stock based / incremental) and NID rate (0.237% - 10.490% in 2018), the importance of anti-abuse provisions will be different.

A NID regime should provide for strict anti-abuse measures, in particular when the benefits provided by the regime are high. It is reasonable to say that there is a greater incentive to use the regime for tax planning purposes when its benefits are high. In addition, a NID regime should be contained by appropriate limitations of scope to reduce the likelihood of abuse.

The list of limitations of scope and anti-abuse measures contained in this Guidance is not exhaustive.

4.3 Limitations of scope

The following limitations of the scope are likely to make the regime less vulnerable for tax planning:

- In order to incentivize the creation of additional equity, a NID regime should be limited, where applicable, to new equity created after the starting date of the regime.
- Exclusion of own shares: this exclusion prevents the possibility for a company to increase its equity and simultaneously subscribe the new shares.
- Exclusion of shares held in other resident and non-resident legal persons: this exclusion tackles the possibility to cascade the NID through chains of equity injection.
- The application of the NID should not create nor increase tax losses. Consequently, a negative result due to this deduction should not generate a loss carry forward.
- Exclusion of assets not necessary for conducting business: this exclusion avoids benefits through NID on assets that do not generate taxable income (for instance, luxury goods, artwork, etc.).
- No deduction for capital which is allocated to a permanent establishment if the profits attributable to the permanent establishment are tax exempt. If the PE were a legal person (a subsidiary), the parent company holding its capital would have to exclude those shares from the NID base.

4.4 Special anti-abuse provisions

The below tax avoidance situations involving transactions between related parties have been identified relevant to a NID regime. Special anti-abuse rules addressing these situations are likely to make the regime less vulnerable for tax planning:

(a) Cascading through intra-group loans and loans involving associated enterprises;

An equity injection is granted to company A located in an NID country. Company A uses this injection to grant a loan to a related company B. Company B injects equity in company A or to another related company (company C). This would allow multiplying the NID deduction starting from only one genuine equity injection.

(b) Cash contributions and contributions in kind;

Cash contributions raise the issue of cascading the NID through triangular situations within multinational groups. A group could circulate a cash contribution through local and foreign companies to multiply the NID deduction at the level of the country granting the deduction.

For contributions in kind the value of the asset should not exceed the market value.

(c) Transfer of participations;

Since participations should be deducted from the NID base, a group could maximise the NID deduction by placing participations in companies that cannot claim a NID deduction. The amount of NID deduction could therefore be maximised at the consolidated level of the group.

(d) The re-categorisation of old capital as new capital through liquidations and the creation of start-ups;

An existing company, with retained earnings, is liquidated (increase of the parent company A equity through the incorporation of the retained earnings of the subsidiary). Then, a new company B is created. If the participation in company B was not held by the parent, the NID base of the parent would not be reduced by the value of the participation in the subsidiary.

(e) The creation of subsidiaries;

See (d). In general, reorganizations carried out without generating taxable profits in the transferring company should also be NID neutral.

(f) Acquisitions of businesses held by associated enterprises;

A group would increase its NID base by transferring to company A a business that was already held by a subsidiary or a sister company B. The price paid by company A to company B would increase company B equity although the business remains within the same group of companies.

(g) Double-dipping structures combining interest deductibility and deductions under the NID;

Company A in a non-NID country would take a loan from a third party and use the funds to inject equity in a subsidiary, company B located in an NID country. At a consolidated level, there would be at least two deductions based on the same funds: the interest on the loan and the NID deduction on equity.

(h) Increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date;

See (a).

4.5 General NID anti-abuse provision

NID should be refused for actions or transactions

i. carried out without any substantial economic or trading purpose but with the aim of receiving NID or
ii. carried out with related parties and that have the main purpose of converting old equity into new equity.

4.6 Burden of proof

It is important that in the case of the special anti-abuse provisions the burden of proof lies with the taxpayer and not with the tax administration.

The tax payer should have the right to prove that any transaction is carried out for valid commercial reasons and does not lead to a duplication of the benefit within a group.

4.7 Cross border situation

It should be ensured that the special anti-abuse provisions also work in a cross border situation. For this purpose each Member State with a notional interest deduction regime shall inform any other concerned Member States which have a notional interest deduction,

i. If it has grounds for supposing that there is a tax loss in the other Member States or
ii. If a tax payer received a reduction in tax which should not give rise to a second deduction in the other Member States.

4.8 Audit requirements

Assuming that modalities in which audits are carried out are a national prerogative, Member States should take into consideration potential risks inherent in their notional deduction regime when verifying that the activities of the entities benefitting from the regime at issue meet the requirements of this Guidance.

4.9 Monitoring

Regimes that have been subject to an assessment in the Code of Conduct Group will be monitored.

This monitoring will consist of Member States and third countries providing data that shows how these regimes are implemented in practice. This data should be provided on a yearly basis to the Code of Conduct Group. Based on the data provided, or its absence, the Code of Conduct Group may decide whether it is appropriate to reopen a review of the regime concerned.

The following data should be provided:

- the number of taxpayers benefitting from the regime,
- how many of the companies benefitting from the regime are domestic companies and
- how many are foreign or foreign owned companies and
- the aggregate amount of income benefitting from the regime.

Treatment of Partnerships under criterion 2.2

The COCG agreed on the following set of questions to be sent to the relevant criterion 2.2 jurisdictions in order to clarify the nature of the different partnerships within each jurisdiction, and help determine if and how they should be covered by the substance requirements~~:~~. It should be noted that, as per the Scoping Paper, substance requirements in any case should apply to all companies and undertakings that carry out relevant activities and can earn income in 2.2 jurisdictions.

1/ Can a relevant activity be carried out through a partnership?

Every 2.2 jurisdiction should clarify whether each type of partnership mentioned in its legislation can be used to carry out a relevant activity and earn income therefrom[42]. At this stage, this question should be considered irrespective of whether the activity is carried out in its own name or in the name of the partners.

If partnerships are not allowed to carry out any relevant activities and earn income in a particular jurisdiction, then those partnerships could be excluded from the substance requirements in that particular jurisdiction.

However, if they can in principle be used to carry out relevant activities, additional questions could narrow down the application of substance requirements.

[42] Relevant activity being defined under the Scoping Paper by reference with the FHTP Guidance on non-IP regimes as: headquarter business, distribution and services centres, financing and leasing, fund management, banking, insurance, shipping, holding activity (including pure equity holding).

2/ Can partnerships that can carry out relevant activities have legal personality?

If the jurisdiction confirms that partnerships can have legal personality (either automatically or by opting to have one), then the partnerships are akin to companies, and should be in the scope of the substance requirements.

Therefore, partnerships with legal personality would be required to meet the substance requirements for carrying out a relevant activity, and to file information on their substance for control and exchange of information purposes.

If the jurisdiction says that partnerships cannot have (or do not opt to have) legal personality, additional questions could narrow down the application of substance requirements.

3/ Can the partners or beneficial owners of a partnership carrying out a relevant activity without legal personality be non-residents?

If the answer is negative, partnerships of the jurisdictions concerned could be left out of the substance requirements, because non-resident partners or beneficial owners could not use them to shift profits.

If the answer is positive (i.e. they can be non-residents), the partnership should fall within the scope of substance requirements, because non-resident partners or beneficial owners could use them to shift profit.

Where a partnership has no legal personality, substance would be checked at the level of the partnership. This would allow the authorities to easily assess the substance and apply sanctions where relevant. It would also ease the exchange of information with relevant Member States.

ANNEX 4

Guidance on defensive measures in the tax area towards non-cooperative jurisdictions

I. GENERAL

1. The Council, in its Conclusions of 12 March 2019 on the revised EU list of non-cooperative jurisdictions for tax purposes welcomed the fact that the list "*is being taken into account by the European Commission in the implementation of EU financing and investment operations, as well as the agreements reached in respect of coordinated defensive measures in the non-tax area vis-à-vis the non-cooperative jurisdictions since the Council conclusions of 5 December 2017*".

2. In the conclusions, the Council also:

   i) reiterated its invitation to the Code of Conduct Group to finalise discussions on further coordinated defensive measures, without prejudice to Member States' obligations under EU and international law[43], and

   ii) invited (along the lines of point 19 of the Council conclusions of 5 December 2017) "*the EU institutions and Member States, as appropriate, to take the revised EU list of non-cooperative jurisdictions for tax purposes set out in Annex I into account in foreign policy, economic relations and development cooperation with the relevant third countries […] without prejudice to the respective spheres of competence of the Member States and of the Union as resulting from the Treaties*"[44]

[43] This point was also reiterated by the Council in its 14 June 2019 conclusions (point 16 concerning progress achieved by the Code of Conduct Group (doc. 10340/19)./

[44] Council conclusions of 12 March 2019, points 19 to 21 (doc. 7441/19).

3. The objective of this Guidance is to set out the principles of co-ordination of actions by Member States in this area, whilst providing further details as regards the proposed defensive measures of a legislative nature to be applied, in accordance with EU and national law, including international obligations, to non-cooperative jurisdictions as long as they are listed by the EU.

4. The list of non-cooperative jurisdictions and the defensive measures, when applicable, encourage a positive change, as they have the preventive effect of sending a strong signal to the jurisdictions concerned. Placement of non-cooperative jurisdictions on the list for the tax purposes has proven to have a dissuasive effect that encourages compliance with the COCG screening criteria, as well as other relevant international standards.

5. It is important that all Member States provide for in their national legislation efficient protection mechanisms that help to fight against the erosion of Member States' tax bases through tax fraud, evasion and abuse.

6. Therefore effective and proportionate defensive measures of a legislative nature in the tax area should be taken by the Member States, in accordance with their national law, in addition to the non-tax measures already taken by the EU, to effectively discourage non-cooperative practices in the jurisdictions concerned. Member States have already agreed to apply at least one of the administrative measures in the tax area as listed in Annex III of the Council conclusions of 5 December 2017.

7. It should be noted that this Guidance is without prejudice to the respective spheres of competence of Member States to apply additional measures or maintain lists of non-cooperative jurisdictions at national level with a broader scope.

8. While, in the absence of EU legislation, the exact configuration, as well as assessment of the effectiveness and proportionality of legislative and non-legislative defensive measures is left to the competence of Member States, it is important that taxation systems and administrative practices of Member States contain an appropriate mix of minimum level measures that ensure these objectives are reached.

9. Together with the list itself, the defensive measures should have the effect of encouraging a positive change leading to the removal of jurisdictions from the list.[45] The defensive measures would not have any dissuasive effect if the taxation would be the same whether it were a listed or non-listed jurisdiction. Therefore, defensive measures in tax area included in this Guidance should be specific measures that are different from the general administrative practices and tax rules in the Member States.

[45] Council conclusions of 5 December 2017, paragraph 20.

II. DEFENSIVE ADMINISTRATIVE MEASURES

10. To ensure coordinated action, Member States should apply appropriate administrative measures that aim to prevent using the legislation, policies and administrative practices of listed jurisdictions for aggressive tax planning, evasion or abuse.

11. As already agreed in the Council Conclusions of 5 December2017, Member States should continue to ensure that they apply at least one of the following administrative measures in the tax area, thus attaching greater importance to audit and control of such arrangements:

    a) reinforced monitoring of certain transactions;

    b) increased audit risks for taxpayers benefiting from the regimes at stake;

    c) increased audit risks for taxpayers using structures or arrangements involving these jurisdictions.

III. DEFENSIVE MEASURES OF A LEGISLATIVE NATURE

12. The Council recommended in its conclusions of 5 December 2017 a number of types of defensive measures of a legislative nature in the tax area that could be applied by the Member States, without prejudice to the respective spheres of competence of the Member States to apply additional measures.

13. In line with the Council recommendation that Member States take certain co-ordinated defensive measures in the tax area, in accordance with their national law and in accordance with the obligations under EU and international law, and for the purposes of achieving the objectives of this Guidance, every Member State should apply at least one of the specific legislative measures which are described in more detail in this Chapter III. A Member State could also apply these measures in a more targeted manner, specifically addressing the issues of non-compliance with the COCG screening criteria, for which a jurisdiction is listed.

14. Whichever the measure chosen, it is appropriate that the Member State concerned ensures that the measure has the effect of encouraging a positive change leading to the removal of jurisdictions from the list. The measure would be considered to have this effect when it is applied in a situation linked to a listed jurisdiction and not applied either once the specific reason for listing of that jurisdiction is resolved or as soon as possible thereafter. Member State could extend the application of the defensive measures to jurisdictions on its national list, or, in the absence of such a list, to the corresponding issues of non-compliance with COCG screening criteria. Moreover, removal of a jurisdiction from the EU list does not exclude the possibility of applying defensive measures in case a jurisdiction remains on the national list of a Member State.

15. Where applicable and in accordance with national law, the Member State could also apply a reversal of the burden of proof and special documentation requirements to reinforce the effect of any of the defensive measures. Nevertheless, application of any defensive measures of legislative nature is without prejudice to provisions of national law that allow the taxpayer to provide counter-evidence.

a) Non-deductibility of costs

16. Member States that opt for this measure should deny deduction of costs and payments that otherwise would be deductible for the taxpayer when these costs and payments are treated as directed to entities or persons in listed jurisdictions. The measure should include for example interests, royalties and other concessions on intellectual property (IP) assets and service fees.

b) Controlled Foreign Company (CFC) rules

17. Member States that opt for this measure should include in the tax base of the taxpayer the income of an entity resident or a permanent establishment situated in a listed jurisdiction. Member State could apply this measure in accordance with to the rules laid down in articles 7 and 8 of the Anti-Tax Avoidance Directive (EU) 2016/1164.

18. The rules of the Anti-Tax Avoidance Directive (ATAD) operate without a link to the EU-list. After having implemented the ATAD based CFC-rules all Member States should apply those rules on a worldwide basis. A Member State that wishes to use these rules for the purposes of a defensive measure would need to adjust the rules to ensure the rule has the required effect as explained in paragraph 14. The details of this adjustment would depend highly on the national implementation of the CFC-rules in that Member State. These adjustments could include for example, not applying exemptions based on ATAD Article 7(3) or (4) when these are applied to non-listed jurisdictions, including all income of the controlled foreign company in a listed jurisdiction instead of applying ATAD Article 7(2)(a) or (b), applying a lower ownership threshold or a higher effective tax rate test than the one applied for non-listed jurisdictions. Member State that maintains a list in conjunction with CFC-rules, could apply the rules applied to listed jurisdictions as a defensive measure for the purposes of this Guidance.

c) Withholding tax measures

19. Member States that opt for this measure should apply withholding tax at a higher rate for example on payments such as interest, royalties, service fee or remuneration, when these payments are treated as received in listed jurisdictions.

20. Alternatively or in combination with this measure Member States could consider applying specific targeted withholding tax on such payments.

d) Limitation of participation exemption on profit distribution

21. Member States, which have rules that permit excluding or deducting dividends or other profits received from foreign subsidiaries (e.g. holdings), could deny or limit such participation exemptions if the dividends or other profits are treated as received from a listed jurisdiction.

22. Member States that opt for this measure should recognize situations where they apply rules on limitation of participation exemption on profit distribution laid down in Articles 1(2) and 4(1)(a) of the parent-subsidiary Directive (Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States as amended with Directives (EU) 2015/121 and 2014/86/EU) or equivalent domestic rules. Limitation of participation exemption on profit distribution that is based on the Directive as well as similar domestic rules that apply independently of the EU-list would not be considered as a defensive measure for the purposes of EU listing process. Limitation of participation exemption applied to profits from entities in listed jurisdictions should be more stringent towards taxpayers as compared to the rules otherwise applicable, which would entail that the thresholds, as described below, for applying these rules would be lower in case of listed jurisdictions.

23. As a minimum, Member States that opt for this measure should not apply similar restrictions on the limitation as those laid down in the parent-subsidiary Directive Articles 1(2) and 4(1)(a) or possible limitations in equivalent domestic rules to the profit arising from entities in listed jurisdictions.

24. Member States could also consider applying other rules that are stricter towards taxpayer as compared to the limitation laid down in the parent-subsidiary directive or similar domestic rules.

IV. WAY FORWARD AND FURTHER WORK IN THE CODE OF CONDUCT GROUP

25. Member States should ensure that at least one of the defensive measures described in Chapter III of this Guidance is applied from 1 January 2021 at the latest. In case of listing or delisting, Member States should ensure that defensive measures are applied accordingly, as soon as possible, depending on the nature and content of each measure and the rules on enactment of laws in the Member State.

26. Member States should regularly update the Code of Conduct Group on the state of play of defensive measures that they apply under this Guidance. In this context, it is important to recall that any defensive measures should be compatible with the national tax systems of the Member States and without prejudice to the respective spheres of their competence and their obligations under EU and international law. Therefore ensuring effectiveness and implementation of the defensive measures described in this Guidance is within the competence of each Member State.

27. Therefore the Code of Conduct Group should resume reviewing the work on legislative defensive measures in the tax area by July 2021 at the latest. As the first step, by the end of 2021, an overview of defensive measures applied by Member States will take place.

28. As of 2022, taking into account updates of the COCG screening criteria, the specific risks that arise from non-compliance with such standards, as well as the international developments, most notably in the OECD, the Code of Conduct Group will assess the need for further coordination of defensive measures in the tax area and the need to apply defensive measures in a more targeted manner, without prejudice to Member States' obligations under EU and international law. In this context, and to the extent it is necessary to ensure compliance with paragraph 25 of this Guidance, the Guidelines on working methods for an effective monitoring of Member States' compliance with agreed guidance will be applied, in order to ensure that the Code of Conduct Group takes informed decisions, as appropriate.

29. In coordination with the High Level Working Party (Taxation), relevant results of this work should be brought to the attention of the Council, for consideration and political guidance, where appropriate.