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'I/A' ITEM NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee (Part 2)/Council
Subject:	Report by the Code of Conduct Group (Business Taxation) to ECOFIN – Patent boxes: state of play and the way forward

1. The Code of Conduct (Business Taxation) on harmful tax competition (adopted in 1997) essentially sets out criteria for assessing harmful tax measures, which are subject to a voluntary peer-reviewed standstill and rollback commitment. This assessment is completed according to five criteria. The third one is "*whether advantages are available without any real economic substance being generated in the Member States concerned*".

2. Regarding the interpretation of the third criterion regarding existing patent box regimes in the Member States, the Code of Conduct Group agreed in November 2014 that all existing patent box regimes should be assessed according to the modified nexus approach which ensures that they present sufficient economic substance with the Member State concerned.

3. In this context, the Code of Conduct Group concluded that all existing patent box regimes were not compatible with the modified nexus approach and should be put in line with the latter (doc. 16553/1/14 REV 1).

4. In its Conclusions of 9 December 2014 regarding the Code of Conduct Group (Business Taxation) (doc. 16846/14), the Council (ECOFIN) endorsed the report of the Code of Conduct Group during the Italian Presidency, emphasised "*the need to start already in 2015 the legislative process necessary to change the patent box regimes*" and asked the Group to monitor this process.

5. At the meeting of the Code of Conduct Group on 21 September 2016, the Code of Conduct group decided to submit to the Council (ECOFIN) a special report on the state of play and way forward on this issue.

6. The report of the Code of Conduct Group was discussed at the HLWP meeting on 27 October 2016. The HLWP confirmed that the Code of Conduct report should be submitted to COREPER/ Council as I/A Item.

7. Against this background, the Permanent Representatives Committee is therefore invited to suggest that the Council take note of the report setting up the state of play and the way forward, as set out in annex as an "A" item.

REPORT TO ECOFIN CONCERNING THE FRENCH PATENT BOX

1. In November 2014 the Group agreed, in co-ordination with developments at the OECD, on the modified nexus approach as the appropriate method to ensure that patent boxes require sufficient substance. The Group agreed that the EU patent box regimes which had been subject to examination by the Group are not compatible with the modified nexus approach. As a consequence, these EU patent boxes should be changed in line with the compromise; this approach was endorsed by the Ecofin Council in December 2014.

2. The Council Conclusions of 9 December 2014 emphasised the need for Member States to start in 2015 the legislative process necessary to change the patent box regimes and asked the Group to monitor this process. Member States which currently have patent boxes needed to begin the legal processes to close the regimes to new entrants from the end of June 2016 and end all benefits for existing claimants by June 2021.

3. Moreover, the Group agreed that the relevant Member States should submit a report on this issue with their annual notifications of rollback at the Group's first meeting in 2016.

4. During the Netherlands Presidency, all Member States which currently have patent box regimes, except France, have notified the Group of the steps taken to comply with their commitments. In the meeting of 2 June 2016 France declared that no rollback would be necessary since it considered that its regime would not be harmful. The Group asked France to demonstrate the compatibility of its Patent Box regime with the modified nexus approach.

5. The Code of Conduct states that tax measures which provide for a significant lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by the Code of Conduct. The French IP regime tax rate (15%) is significantly lower than the general tax rate in France (33.3%).

6. In the meeting of 21 September 2016 France presented a paper on its Patent Box, reiterating that the French IP regime tax rate of 15% does not affect in a significant way the location of business activities. France claims that a significantly lower level of taxation must be defined by reference to the overall corporate tax environment in the single market and that the absolute level also matters.

7. The Code of Conduct group brings to the attention of the ministers that France is in contravention of the Ecofin Council conclusions of 9 December 2014 (doc. 16846/14) and 8 December 2015 (doc. 14303/15). The Code of Conduct Group confirms that the French Patent box regime, like all the other Member States patent box regimes will be examined against all criteria of the Code of conduct in order to assess their potential harmfulness.