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Delegations will find attached the declassified version of the above document.

The text of this document is identical to the previous version.

Council of the
European Union

Brussels, 2 March 2018
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RESTREINT UE/EU RESTRICTED

FISC 96

NOTE

From:	Chair of the Code of Conduct Group (Business Taxation)
To:	Code of Conduct Group (Business Taxation)
Subject:	Draft letter to Turks and Caicos Islands

Delegations will find attached a document from the Chair in view of the meeting of the Fiscal Counsellors/Attachés on 5 March 2018.

ANNEX

Hon. Sharlene Linette CARTWRIGHT-ROBINSON
Premier
Hon. N.J.S. Francis Building
Grand Turk
TURKS AND CAICOS

Brussels, 6 March 2018

Subject: The EU list of non-cooperative jurisdictions for tax purposes

- **Follow-up to the screening process, criterion 2.2**

Your Excellency,

We would like to thank you for your response to the questionnaire on criterion 2.2 of the EU listing criteria. We would also like to thank you for the information provided in previous exchanges. On the basis of your explanations and publicly available information, the Code of Conduct Group (Business Taxation) has been able to clarify certain aspects but has also identified some concerns as regards the compliance of your legal and regulatory framework with this criterion, as further clarified below.

This criterion has been agreed by the EU Finance Ministers in November 2016[1] and its scope has been further defined by the same Ministers in February 2017 (scope of criterion 2.2). In addition, the Code of Conduct Group (Business Taxation) last year agreed detailed Terms of Reference for its application. These documents are attached to this letter.

According to criterion 2.2, jurisdictions should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction. In doing this analysis, the absence of corporate income tax or a nominal corporate income tax have been taken into account, in accordance with the above-mentioned scope of criterion 2.2.

Following a technical analysis the main concern relates to de facto lack of substance, which may be due to the absence of legal substance requirements, for entities doing business in or through your jurisdiction. The absence of legal substance requirements, as explained in the Terms of Reference, increases the risk that profits registered in a jurisdiction are not commensurate with economic activities and substantial presence which is a concern from the perspective of criterion 2.2. In light of this, the Code of Conduct Group has provisionally considered the tax system of the Turks and Caicos Islands as harmful.

[1] The official publication of these Council Conclusions can be found in the *Official Journal of the European Union*: OJ C 461, 10.12.2016, page 2.

In addition, the same technical analysis revealed that, in your jurisdiction, legal mechanisms exist that enable the granting of advantages only to non-residents or in respect of transactions carried out with non-residents, in particular, through the incorporation of entities which are not permitted to carry on business in your jurisdiction.

As a result of this, we would like to take this opportunity to verify whether the Turks and Caicos Islands intends to address the identified concerns and commit to future changes.

We invite the Turks and Caicos Islands to cooperate with the Code of Conduct Group and commit, at a high political level, to addressing the above mentioned concerns. In particular, to address the issues that arise in connection with entities operating without any substance, the Turks and Caicos Islands is asked to give reassurances to EU Member States on this issue in line with the Terms of Reference attached to this letter. The Turks and Caicos Islands is asked to discuss with the Code of Conduct Group what further steps could better ensure that businesses have sufficient economic substance. A way to achieve this could be through the imposition of substance requirements, where appropriate. Moreover, this may require that you introduce additional accounting and tax reporting obligations such that an appropriate notification regime for entities that give rise to the risks and concerns underlying criterion 2.2 can ensure the collection and subsequent exchange of relevant information with Member States.

The Code of Conduct Group will not recommend to the Council of the EU to include the Turks and Caicos Islands in the list of non-cooperative jurisdictions for tax purposes if you will commit to correct the identified concerns by 31 December 2018 at the latest. To this end, the Code of Conduct Group would appreciate receiving a precise timeline and a description of the steps for the implementation of the changes by the date indicated below.

The Code of Conduct Group will continue monitoring the commitments taken by the identified jurisdictions to consider whether they have been fulfilled and, as the case may be, will recommend an update to the EU list of non-cooperative jurisdictions for tax purposes.

We would be grateful for your response to reach us by 31 March 2018.

Sincerely,

Fabrizia Lapecorella

c.c. General Secretariat of the Council
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ANNEX

Scope of criterion 2.2

1. For the purposes of application of criterion 2.2, the absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero by a jurisdiction should be regarded as within the scope of Paragraph A of the Code of Conduct for Business Taxation of 1 December 1997 (Code of Conduct).[2]

2. In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct [3], because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero"[4], then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2[5] has been met.

3. In the context of criterion 2.2 the fact of absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero can not alone be a reason for concluding that a jurisdiction does not meet the requirements of criterion 2.2.

4. A jurisdiction should be deemed as non-compliant with criterion 2.2 if it refuses to engage in a meaningful dialogue or does not provide the information or explanations that the Code of Conduct Group may reasonably require or otherwise does not cooperate with the Code of Conduct Group where it needs to ascertain compliance of that jurisdiction with criterion 2.2 in the conduct of the screening process.

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2 "Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community." (OJ C 2, 06.01.1998, p. 3)

3 "Within the scope specified in paragraph A, tax measures which provide for a significantly 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 this code. Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor." (OJ C 2, 06.01.1998, p. 3)

4 This may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.

5 Criterion 2.2 reads as follows: *"The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction."*

Terms of reference for the application of the Code test by analogy

A. General framework

1. Criterion from ECOFIN Council Conclusion on 8th November 2016

The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction.

2. Scope of Criterion 2.2 (ECOFIN February 2017)

1. For the purposes of application of criterion 2.2, the absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero by a jurisdiction should be regarded as within the scope of Paragraph A of the Code of Conduct for Business Taxation of 1 December 1997 (Code of Conduct).[6]

2. In this respect, where criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct[7]*, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero"*[8]*, then the five factors identified in paragraph B of the Code of Conduct should be applied by analogy to assess whether the criterion 2.2*[9] *has been met.*

3. In the context of criterion 2.2 the fact of absence of a corporate tax or applying a nominal corporate tax rate equal to zero or almost zero cannot alone be a reason for concluding that a jurisdiction does not meet the requirements of criterion 2.2.

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6 *"Without prejudice to the respective spheres of competence of the Member States and the Community, this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of business activity in the Community." (OJ C 2, 06.01.1998, p. 3)*

7 *"Within the scope specified in paragraph A, tax measures which provide for a significantly 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 this code. Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor." (OJ C 2, 06.01.1998, p. 3)*

8 *This may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.*

9 *Criterion 2.2 reads as follows: "The jurisdiction should not facilitate offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction."*

4. A jurisdiction should be deemed as non-compliant with criterion 2.2 if it refuses to engage in a meaningful dialogue or does not provide the information or explanations that the Code of Conduct Group may reasonably require or otherwise does not cooperate with the Code of Conduct Group where it needs to ascertain compliance of that jurisdiction with criterion 2.2 in the conduct of the screening process.

3. General remarks

- Scope of Criterion 2.2 as defined by ECOFIN considers the absence of a corporate tax rate or a nominal tax rate equal to zero or almost zero in a jurisdiction as a "measure" significantly affecting the location of business activities (Paragraph A of the Code of Conduct).

- To this extent, Criterion 2.2 is aimed at verifying whether this "measure" facilitates offshore structures or arrangements aimed at attracting profits which do not reflect real economic activity in the jurisdiction.

- Criterion 2.2 applies only when the standard code assessment (i.e. criterion 2.1) cannot be applied because of the absence in a third country jurisdiction of a corporate tax system or because the jurisdiction applies a nominal corporate tax rate equal to zero or almost zero.

- Criterion 2.2 assesses the legal framework and certain economic evidences of a jurisdiction with regard to the five criteria established under paragraph B of the Code of Conduct to be interpreted by analogy.

- Advantages granted by a third country jurisdictions influencing in a significant way the location of business activities have to be seen in connection with a nominal corporate tax rate equal to zero or almost zero as well as in connection with the absence of corporate taxation, to the extent in both cases the standard Code of Conduct test could not be applied. These latter features have in fact to be considered *per se* as advantages to be assessed under this code test.

- In general terms, any guidance developed by the COCG over the years for assessing tax measures within the scope of the 1998 Code of Conduct should be applied consistently and by analogy for the purpose of this test[10].

- A jurisdiction can only be deemed to have failed the assessment under this criterion when 'offshore structures and arrangements attracting profits which do not reflect real economic activity in the jurisdiction' are due to rules or practices, including outside the taxation area, which a jurisdiction can reasonably be asked to amend, or are due to a lack of those rules and requirements needed to be compliant with this test that a jurisdiction can reasonably be asked to introduce.

- The introduction of a CIT system or a positive CIT rate is not amongst the actions that a third country jurisdiction can be asked to take in order to be in line with the requirements under this test, since the absence of a corporate tax base or a zero or almost zero level tax rate cannot by itself be deemed as criterion for evaluating a jurisdiction as non-compliant.

- Nonetheless, criterion 2.2 implies automatic non-compliance for those jurisdictions that refuse to cooperate with the EU for the assessment of their legal framework.

B. Gateway test

1. Gateway criterion as it reads now in the Code of Conduct

   "Within the scope specified in paragraph A, tax measures which provide for a significantly 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 this Code."

2. Guidelines for application by analogy

- The functioning of the Gateway test seems rather clear from the definition of scope of Criterion 2.2 as agreed by Ecofin in February this year.

[10] See doc. 14039/98 of 11 December 1998 "Code of Conduct (Business Taxation) – Interpretation of Criteria" and its further updates.

- In particular, this test is satisfied when "*criterion 2.1 is inapplicable solely due to the fact that the jurisdiction concerned does not meet the gateway criterion under Paragraph B of the Code of Conduct, because of the "absence of a corporate tax system or applying a nominal corporate tax rate equal to zero or almost zero"*

C. Criteria 1 and 2

1. Criterion 1 of the current Code Criteria as it is now

   "*Whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents*"

2. Criterion 2 of the current Code Criteria as it is now

   "Whether advantages are ring-fenced from domestic market, so they do not affect the national tax base"

3. Guidelines for application by analogy

- For the purpose of applying criterion 2.2., "advantages" should be understood as the existence of zero or almost zero taxation or the absence of CIT.
- Factor 1 as well as factor 2 of the current code criteria contain two main elements: (a) legal ring-fencing and (b) de-facto ring-fencing.
- De jure ring-fencing occurs when advantages are only granted to non-residents by the laws and regulations governing the establishment and operations of businesses in a given jurisdiction.
- Where there is no an effective CIT-system in place, it should be then assessed whether aspects of the legal framework, including non-CIT aspects, effectively provide for a ring-fenced scenario.
- An example of that would be non-tax requirements for companies to allow for the residence or for the access to the domestic market of the tested jurisdiction.

- For this purpose, any measure leading to a different treatment between domestic companies and companies held by non-residents or whose activities are disconnected from the domestic market shall be assessed.

- If for instance a jurisdiction grants "advantages" to a company only if it abstains from activities in the local economy (criterion 2) or only to the extent such activities are dependent on a specific business license (criterion 1 and 2) or only to the extent the activities are undertaken by non-residents (criterion 1), this could be assessed as a possible feature of a ring fencing system in place. By analogy this could also be relevant for other taxes (i.e. other than CIT).

- De-facto ring-fencing usually refers to a situation whereby the advantage is not explicitly granted by a country only to non-residents although, in fact, it is enjoyed only or almost only by non-residents.

- As to the de-facto ring-fencing, it is usually considered how many of the taxpayers benefitting from the advantage are in fact non-residents. If, for instance all or nearly all of the subjects benefitting from zero taxation are non-residents (including domestic companies with foreign shareholding), sub-criteria 1 (b) as well as 2 (b) would be considered as met (i.e. the jurisdiction would be deemed to be non-compliant under this step of the Code test).

D. Criterion 3

1. Criterion 3 of the current Code Criteria as it is now

"Whether advantages are granted even without any real economic activity and substantial economic presence with the Member State offering such tax advantages"

2. Guidelines for application by analogy

In order to evaluate whether advantages are granted even without any real economic activity and substantial economic presence, it has to be ascertained:

- whether a jurisdiction does require a company or any other undertaking (e.g. for its incorporation and/or its operations) the carrying out of real economic activities and a substantial economic presence:

    - "Real economic activity" relates to the nature of the activity that benefits from the non-taxation at issue.

    - "Substantial economic presence" relates to the factual manifestations of the activity that benefits from the non-taxation at issue.

    - By way of example and under the assumption that, in general, elements considered in the past by the COCG are relevant also for this analysis, the current assessment should consider the following elements taking into account the features of the industry/sector in question: adequate level of employees, adequate level of annual expenditure to be incurred; physical offices and premises, investments or relevant types of activities to be undertaken.

- whether there is an adequate de jure and de facto link between real economic activity carried on in the jurisdiction and the profits which are not subject to taxation;

- whether governmental authorities, including tax authorities of a jurisdiction, are capable of (and are actually doing) investigations on the carrying out of real economic activities and a substantial economic presence on its territory, and exchanges of relevant information with other tax authorities;

- whether there are any sanctions for failing to meet substantial activities requirements.

E. Criterion 4

1. Criterion 4 of the current Code Criteria as it is now

"Whether the rules for profit determination in respect of activities within a multinational group of companies depart from internationally accepted principles, notably the rules agreed upon within the OECD"

2. Guidelines for application by analogy

- In assessing the adherence of profit determination rules to internationally agreed standards (e.g. OECD TP Guidelines or other similar accounting standards) first of all it should be verified if and to what extent this analysis is relevant for jurisdictions not applying a CIT system.

- To this aim it seems relevant to consider that a jurisdiction not applying a CIT system should not negatively affect a proper allocation of profits departing from internationally agreed standards. Jurisdictions should take appropriate steps in ensuring taxing countries are able to exercise their taxing rights i.e. via CBCR, transparency and other modes of information sharing.

- Where relevant, it should be ascertained if OECD's agreed principles or similar accounting standards for the determination of profits have been endorsed in a given jurisdiction.

- To this regard, it is critical to ascertain how these rules are implemented and consolidated in the jurisdictions concerned. In the absence of corporate income taxation in a given jurisdiction, also alternative transfer pricing rules can be taken into account, verifying whether they are comparable and compatible with internationally agreed principles (for instance a fair market value approach under international accounting principles).

- This Criterion shall prevent from allowing multinational companies to use transfer pricing rules departing from the OECD Transfer Pricing Guidelines in order to allocate their profits to zero tax jurisdictions.

- Answers to questions from 2.9 to 2. 12 should give sufficient information on how profits are determined highlighting any important department from internationally agreed standards.

F. Criterion 5

1. Criterion 5 of the current Code Criteria as it is now

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

2. Guidelines for application by analogy

- Criterion 5 shall evaluate whether certain features of a legal system, including the establishment of a business on its territory, lack sufficient level of transparency.
- More specifically, it has to be assessed whether any elements of the legal system, including the granting of tax residence or the setting up of companies can be granted on a discretional basis or whether it is bound by the law, verifying whether any legal provision, including non-tax provisions, can be deemed to be discretionary in matters related to the setting up of a company in that jurisdiction.
- This factor shall prevent a jurisdiction from having an insufficient level of transparency within its regulatory framework, considering that advantages as considered in this Code test stem from the registration of a company in a jurisdiction.
- Answers to questions from 2.13 to 2. 16 should give sufficient information on how transparency is ensured in a jurisdiction on certain steps to be undertaken by companies in order to benefit from the advantages provided therein.