Council of the
European Union

Brussels, 18 June 2021
(OR. en)

10900/19
EXT 1

FISC 315

PARTIAL DECLASSIFICATION

of document:	10900/19
dated:	18 June 2021
new status:	Public
Subject:	Note by the Code of Conduct Group Chair on issues requiring procedural and political decisions in the context of the EU listing process

Delegations will find attached the partially declassified version of the above-mentioned document.

Council of the European Union

Brussels, 2 July 2019
(OR. en)

10900/19

RESTREINT UE/EU RESTRICTED

FISC 315

NOTE

From:	Chair of the Code of Conduct Group (Business Taxation)
To:	Code of Conduct Group (Business Taxation)
Subject:	Note by the Code of Conduct Group Chair on issues requiring procedural and political decisions in the context of the EU listing process

Delegations will find attached a note from the Chair of the Code of Conduct Group.

ANNEX

NOT DECLASSIFIED FROM THIS POINT UNTIL PAGE 17

ANNEX 3: GUIDANCE ON FOREIGN SOURCE INCOME EXEMPTION REGIMES

The common characteristic of these regimes is that certain types or all foreign sourced income are exempt from taxation.

1. Previous work of the COCG on Foreign Income Exemption regimes

There are precedents decided by the Group on how to deal with similar regimes.

The treatment of passive income on a territorial basis in the Income Tax Act 2010 of Gibraltar was assessed as harmful on the basis of a draft assessments of 17.10.2012 (see para. 10 of the Groups' report to ECOFIN of 23 November 2012, doc. 16484/12). In the overall assessment it is stated:

'The mere fact that the tax regime of a country charges CT on a territorial basis should not in principle be problematic under the Code of Conduct. Exempting foreign source profits in certain circumstances is acceptable and is recommended to ensure the avoidance of double taxation especially where this concerns active business income. However, a tax system that fully excludes passive income with a foreign link from taxation without any conditions – even if the profits are determined using internationally established principles – bears similarities to a tax regime that provides beneficial treatment for low or no substance offshore companies. Such regimes have consistently been found harmful by the Group.'

In the assessment of criterion 1 and 2 the following is said:

'Both the territorial basis of charge and the treatment of passive income are applied generally to residents and non-residents alike. ***The territorial basis of charge for active business income is fully in line with general international principles concerning the allocation of cross border income, according to which income allocable to a foreign permanent establishment should be taxed in that foreign State (art. 7 OECD Model Tax Convention)****. It is not, however, in line with general international principles when it is applied in a broad manner including passive income, for which taxing rights are generally allocated to the State of residence. As the receipt of foreign passive income by definition requires a transaction with a non-resident, this benefit seems to fall foul of criterion 1 as far as passive income is concerned.'*

Finally, this regime was found harmful under criterion 3 with the following reasoning:

'According to the standard practice for the evaluation of a measure against criterion 3, a measure is found harmful under this criterion if there are no specific requirements with regard to real economic activities and notably any requirement with respect to employment obligations. Despite the charging provision's reliance on the location of the relevant business activities access to the benefits for passive income typically will not require significant substance. This compounds the ease with which non-residents can benefit disproportionately from ITA10. Moreover, the non-taxation of interest is limited to non-trading interest income, implying the absence of genuine economic activity. This is further supported by the data provided by Gibraltar showing the distribution of employees amongst Gibraltar companies. Companies with a tax liability in Gibraltar have an average of 3.9 employees; those without any liability have 0.27 employees. We therefore would suggest a tick ("V") for criterion 3.'

The assessment of the Gibraltar asset holding companies in 2016 followed the same approach. In the draft assessment of 12.4.2016, it is said under criterion 1b:

'The above analysis can be summarised as follows. Based on the existing practice of the Group, the treatment of interest and royalties is not part of this assessment. Trading income is taxed on a territorial basis. However, the effective exemption of the profits of a FPE is in line with international principles and should not be regarded as harmful. Rental income is also taxed on a territorial basis. The non-taxation of income from immovable property in other states is in line with international principles and should not be regarded as harmful. The non-taxation of non-trading rents from movable property located outside Gibraltar is likely to grant tax benefits wholly or mainly in respect of transactions with non-residents. This is potentially harmful. Dividends and capital gains are not subject to CT at all in Gibraltar. The exemption of foreign and domestic inter-company dividends is widely accepted and the effectiveness of Member States' rules in this area is being considered separately. The Group has previously accepted other regimes which do not tax capital gains. On this basis we would propose a tick ("V") for this criterion to the extent that the companies receive non-trading rents in respect of movable assets situated outside Gibraltar.'

2. Principles to be applied by the Group

The continued engagement with the relevant jurisdictions will be carried out on the basis of these precedents. However, specific features of the four regimes will be taken into account, in particular as regards to whether and how active income is subject to tax.
In this respect, regimes with an exemption extended to active income from foreign operations will also be carefully considered as this is the other side of the taxation of outbound investments of resident companies and could trigger cases of double non-taxation.
In line with the Gibraltar precedent[1], the key concept will be the analysis of the definition of the income deemed to have its source in the jurisdiction, as this will trigger taxation or non-taxation of the business income. The assessment of this definition can rely on whether the jurisdiction applies a definition of permanent establishment close to that of the OECD model tax convention as an internationally agreed principle to assess the economic presence of an entity in another jurisdiction for the allocation of the right to tax.

3. Remedies by the relevant jurisdictions

The relevant jurisdictions should either abolish the regimes concerned or they should amend them to remove the harmful features.

In line with previous assessments, the regimes may be amended by introducing taxation of passive income to render the regimes not harmful. The risk of the application of administrative discretion in determining the income not subject to taxation should also be addressed.

With regard to active income, a case-by-case analysis should be made to ascertain whether taxation is applied according to internationally accepted principles, based on the OECD Model Convention on Double Tax Treaties and its commentary. This situation would be taken into account regardless of whether the jurisdiction has a network of DTAs in place. It should also be verified whether a jurisdiction applies substance requirements to companies and has sufficiently robust anti-abuse rules.

[1] Relevant extract of the Gibraltar precedent highlighted in bold here above

NOT DECLASSIFIED FROM THIS POINT UNTIL THE END OF THE DOCUMENT

(page 21)