THE WORLD-WIDE RESPONSE TO THE HARMFUL TAX COMPETITION CAMPAIGNS (UPDATED TO APRIL 2004)[1]

Philip Baker

The thinking behind this paper is this: I thought I would like to find out what had actually happened as a result of the harmful tax competition campaigns up to date. After all, we have had the campaigns for roughly five years, and when they started, people were saying, "This is the end of the world of international tax planning as we know it." I was interested to see whether the world had come to an end.

In looking at what has happened, I am focusing on changes to tax systems, and am using a very broad-brush approach. I am not looking at changes that have come about at the same time due to other campaigns. For example, I am not looking at changes to financial regulation which have come about as a result of the focus on money-laundering – changes that have been brought about by the work of the Financial Action Task Force. I am focusing just on tax system change.

I am also not interested in criticisms of the underlying policy of the harmful tax competition campaigns. One can get almost daily e-mails from the Centre from Democracy and Apple Pie, with trenchant criticisms of the underlying policy. I am not interested in that. What I am interested in here is what has actually happened by way of tax system change, and analysing whether these changes are good or bad.

Background to the Campaigns

Let me turn to the background. There are two principal campaigns – the EU campaign and the OECD campaign.

The EU campaign started in December 1997, with the European Council Conclusions, which proposed a tax package. The tax package was finally adopted in June 2003, after the Council had sorted out the final problem of the Italian milk quota. There are three main elements to the tax package. The one I want to focus on first is the Code of Conduct for Business Taxation, which is sometimes referred to as the *Primarolo Committee Code*, because it involved the establishment of a Committee, originally under the chairmanship of Dawn Primarolo, to examine harmful tax practices within the EU Member States and their dependent and associated territories. That Committee, in 2000, published a list of sixty-six potentially harmful tax regimes (which is reproduced in Appendix II). The Code of Conduct had, in a sense, to wait in the wings for the rest of the package to be agreed. Once the package was agreed, decisions of the Primarolo Committee need to be implemented.

The other campaign is that of the OECD, which was initiated in 1996, but first became public in April 1998 with the publication of the first of four reports, entitled “Harmful Tax Competition: A Global Issue”. There are two aspects of the OECD campaign. One aspect focuses on the thirty OECD-member countries, and entailed a process of identifying potentially harmful preferential tax regimes, and there were some forty-seven identified by 2000. The other aspect of that campaign was the listing of tax havens and the obtaining of commitments from these tax havens. For that, some forty-seven jurisdictions were originally examined to see whether they were tax havens. To date, of the forty-seven, nine have been excluded and are ruled to be non-havens; thirty-three are havens which have made commitments to the OECD; there remain five uncooperative tax havens[2] that have still not made commitments to the OECD. The cooperative havens have now been christened Non-OECD Participating Partners – "NOPPs" – and have been encouraged, under the banner of the Global Forum on Taxation, to develop work on international standards for transparency and effective exchange of information. An Informal Contact Group has been established between representatives of the NOPPs and OECD Member Countries. Meetings have been held in Ottawa in October 2003 and London in February 2004 to develop the notion of a global level playing field.

Mention should also be made of the Savings Income Directive[3], which – strictly speaking – is part of that EU tax package. In many senses this has taken on a life of its own, because it was perceived very early on that the Savings Income Directive would only work if neighbouring countries, major countries elsewhere in the world, and dependent territories signed up to equivalent measures. What started off as an internal directive has taken on a world-wide dimension, in the rush to try and make certain that other countries were also signed up to the same types of measures.

Of those campaigns, it is worth reminding oneself about the original timetable, though it has slipped somewhat. The European Union was planning to roll back harmful regimes within five years from the 1st January 1998, and that deadline has been passed. The OECD had two points of time: the member countries were to end their harmful features by April 2003, and after the end of 2005 there were to be no benefits obtained. By then, the tax havens were to have ended their harmful features. All that has slipped, and we are now looking at 2010 or 2011 – certainly within the European Union – for the ending of benefits from some existing tax practices.[4]

What has also changed has been the focus of the campaigns. One criticism which can be made of the campaigns is that they never assessed precisely what aspects of tax regimes actually were harmful. They identified harmful tax competition, without saying what really were the harmful elements. For example, the EU Code of Conduct has only one paragraph (paragraph B) that talks about what is harmful and it refers to:

> "Tax measures which provide for a significantly lower effective level of taxation … than those levels which generally apply in the Member State in question …"

The OECD's report has only five paragraphs which consider what may be harmful, and it is very hard to see from these what they really had in mind.

What has made matters somewhat worse is that, as the work has proceeded – particularly the OECD work – there has been a shift: ring-fencing was dropped as a criterion for tax havens, and the whole campaign shifted towards transparency and exchange of information, so that what became harmful was lack of transparency and the lack of willingness to exchange information. Because there was uncertainty as to what is "harmful", there was also uncertainty as to what states had to do in order to comply with the demands of the campaigns.

The Impact of the Campaigns

What have the campaigns actually made states do, and what has the impact of this been on the campaigns themselves? There is a very simple comment that one can make at the beginning: the campaigns have subjected different jurisdictions to different degrees of pressure to change. That is not a simplistic, "lack of level playing field" comment; it is rather a recognition of the fact that some jurisdictions were subject to both campaigns, and some to neither. The seventy-or-so jurisdictions affected fall into six groups, which have been under varying degrees of pressure, and have responded in different ways.

Group 1: *The EU and OECD Member States*

In the first group are those states that are <u>both</u> members of the European Union and members of the OECD. All of the present fifteen EU states are members of the OECD, and so these countries were subject to both of the campaigns. At the same time, because they are members of the European Union, they are also subject to review under the *state aid* provisions of the Treaty of Rome, and they are subject to the increasingly perverse jurisprudence of the European Court of Justice on direct taxes. So there is a lot of pressure coming on these states, from different directions, to change their tax systems.

Of the fifteen, three have not felt much pressure. The United Kingdom, for example, has not been cited by the European Union or the OECD; Italy, through not having implemented the Trieste regime, has not had a particular problem; and Sweden has not particularly faced a problem either. But Austria, Belgium, Denmark, France, Germany, Ireland, Luxembourg, Netherlands, Portugal and Spain have all had regimes identified by the European Union or the OECD or both.

Ireland is crucial in identifying what has happened, because, very early on, the Irish - recognising that the Dublin and Shannon schemes would have to give way under this twin pressure - looked at the wording of the Code, and saw that what was defined as harmful was any regime with a significantly lower rate of tax than that generally applied. As you know, the Irish said, “Let’s just have a generally low tax rate for everybody. We’ll get rid of Dublin and Shannon, and we’ll just have a generalised low rate of tax at 12.5%” – which they have had since 2002. And, of course, that does comply with the words of the OECD and the EU campaigns, because it is a generalised rate, and there is no regime with a significantly lower rate than the one generally applicable. So Ireland has led the way by saying that you can get out of this problem by having a generalised low regime. Most recently Ireland has announced (in December 2003) a new holding company regime intended to be the most attractive of similar regimes in virtually all the EU, OECD states.

The other country I want particularly to mention is the Netherlands. One may say that it was the winner of the EU competition: of the forty-seven regimes judged potentially harmful, ten of them belonged to the Netherlands. Of those ten, five were old ruling practices, and the Netherlands responded to that in 2002 by introducing new types of ruling practices. The Netherlands, again, has pointed the way by saying that you can have a ruling practice, provided that it is one of two types – an advanced pricing agreement ("APA"), because, in the transfer pricing world, APAs are very acceptable; or an advanced taxation ruling ("ATR"), which tells you how particular legislation will impact on a particular transaction. Both of those are acceptable types of rulings, and the Netherlands has brought those in to replace the old type of rulings.

Group 2: *The non-EU, OECD Member States*

In the second group of jurisdictions are the other fifteen OECD-member countries, who are not EU members, and who, because they are not, have not been subject to the Primarolo Committee, though some have been part of the attempt to expand the Savings Income Directive. Countries in this group have not been under the same sort of pressure as countries in the first group.

Switzerland abstained on the original OECD report, so there must be a question mark whether Switzerland is subject to either of the campaigns, and certainly whether it is subject to any OECD requirement to change its practices. Swiss regimes have, though, been examined as part of the OECD campaign. As at April 2004, the Swiss 50/50 regime is still under scrutiny, largely it seems because no one quite understands what the regime means. What has also happened with Switzerland is that it has become a key country for the Savings Income Directive; in the recent draft agreement Switzerland agrees that it will implement equivalent measures to the Savings Income Directive.[5]

There is also a big question mark as whether anybody can make the United States carry out any changes, but the one tax practice of the United States which was identified was the foreign sales corporation, and for these the WTO litigation lies in the background. That has driven the United States to abandon foreign sales corporations and to move towards an extra-territorial income exclusion and then possible subsequent legislation. So the United States, in a sense, is subject to slightly different pressures from the OECD and European Union.

Group 3: *The EU candidate countries*

In the third group are the ten countries due to join the European Union in May 2004. You might have thought that they would be under a lot of pressure, because these countries – as a condition of joining – have to show that their tax systems will comply with the *acquis communautaire*, which includes the Code of Conduct, state aid provisions and the Directives. In fact, some of these countries have taken the opportunity, when joining the European Union, of making their tax regime both EU- and OECD-compliant and even more attractive than it was before.

The classic example here is Cyprus. The Cypriots realised that the old 4¼% offshore regime could not survive joining the European Union, so they followed Ireland. Cyprus has gone for a generalised low corporate tax regime – a 10% rate, which will apply to all Cyprus companies. But they have added further "whistles and bells" – an exemption for foreign income, a participation regime based upon a minimum 1% shareholding, an exemption for capital gains and a 50% interest exclusion. Cyprus has taken the opportunity of joining the European Union to introduce a more attractive tax regime than it had previously, and one more attractive than anywhere else in the European Union (other than perhaps Estonia, with its 0% corporate tax rate).

Group 4: *The dependent and associate territories*

In the fourth group are the dependent or associated territories of the EU and OECD member states. Both the Code of Conduct and the OECD campaign required that similar principles should be applied to these territories, and they have come under a fair degree of pressure.

Gibraltar is, of course, *sui generis*. It is within the European Union for most purposes, and so it is subject to the state aid provisions and ECJ jurisdiction. It has had challenges brought to its special regimes for qualifying companies and exempt companies, and it is now talking about following Cyprus and Ireland – or, more exactly, Estonia – by having a generalised corporate tax rate of 0%. But Gibraltar wanted local utility companies and local financial services companies to be excluded from the 0%, and the European Commission has recently ruled that this would fall foul of the state aid provisions. No doubt Gibraltar will need to find other sources to replace its lost revenue if it moves to a zero rate of corporate tax.

Aruba and the Netherlands Antilles have had to comply, and they have done so by dropping their offshore corporate regime in favour of a generalised rate, though they have not gone for a low rate: they have adopted a generalised higher rate, but with a participation exemption and a ruling system similar to that of the Netherlands.

Jersey, Guernsey and the Isle of Man have decided upon a general 0% corporate income taxes, so that there will no longer be any exempt companies or any need for them. The issue they then face is how to match the loss of revenue from other sources: Jersey is considering a 5% sales tax and cuts in personal income tax allowances.

The Caribbean jurisdictions of Anguilla, British Virgin Islands, Montserrat and the Turks & Caicos Islands have been under less direct pressure; they seem to be biding their time to see what changes they need to make to their tax system in general.

Group 5: *The tax havens*

That is largely true also of the penultimate group, the identified tax havens. Most of the thirty-three cooperative jurisdictions have so far only made their commitment. Some of them – like the Cayman Islands – have concluded tax information exchange agreements, but otherwise they are waiting to see what are the non-harmful tax regimes and then they will make the changes. Recently several have signed up to measures equivalent to those in the Savings Income Directive.

As to the uncooperative havens – Andorra, Liberia, Liechtenstein, Marshall Islands, and Monaco – I think it is fair to say that they are coming under increasing pressure to make changes, at least initially by making a commitment, but also by changing their tax system. So, for example, Monaco has negotiated a new tax treaty with France, with greater exchange of information. Liechtenstein is one of the jurisdictions that has to be signed up to the Savings Income Directive before it goes ahead. We have the extreme case in Liberia, where the Americans engineered a regime change.

Group 6: *The non-havens*

At the other extreme of the spectrum, the last group is composed of the non-havens – the jurisdictions that were not characterised as havens by the OECD. There were nine jurisdictions which were on the original list of forty-seven, but proved they were not havens; they have been under no pressure to change, and I do not think any of them have had significant changes to their tax system.

Then, of course, there are others, who were never on the list at the beginning – Hong Kong, Labuan and Singapore. These countries have been completely off the hook. Singapore, for example, has been introducing new preferential regimes for financial service companies and for expatriate employees, making themselves more attractive because they have been outside of the whole process completely.

The OECD 2004 Progress Report

There is an air of self-congratulation about the OECD's 2004 Progress Report. While the public attention has largely been focused on the tax haven aspect of the OECD campaign, this report focuses more on the aspect that relates to OECD Member Countries. The Report notes that, in 2000, 47 preferential tax regimes had been identified in 9 categories. Of these 47, 18 have been abolished, 14 have been amended so that the potentially harmful features have been removed, 13 have been found not to be harmful, and two regimes – the Swiss 50/50 practice and the Luxembourg 1929 companies – are still being assessed (see Appendix C). Taken by itself, this looks very impressive. However, in some jurisdictions – Ireland for example – the regimes which have been abolished have simply been replaced by the generalised, low tax rate.

Published alongside the 2004 Progress Report is a bulky, composite document, entitled the Consolidated Application Note: this contains guidance on the application of the 1998 Report to preferential tax regimes. This Consolidated Note represents work which has been taking place within the OECD, and essentially identifies what aspects of a tax system, and of certain particular regimes, are potentially harmful. A tax system, even if it contains certain preferential regimes, but which successfully avoids these harmful elements, will not be regarded as involving any harmful tax practice.

The Note discusses four general aspects of tax systems: transparency and exchange of information, ring fencing, transfer pricing, and a rulings regime. It then considers three specific regimes: holding company regimes (and similar preferential tax regimes), fund management regimes, and shipping regimes. Most of the comments on these seven areas are fairly bland and general, largely repeating the aspects of the 1998 Report. The content is clear, however: a tax system can have a rulings practice, it can have a holding company regime, a regime for fund management, and a special shipping regime – provided it avoids the elements identified in the Note, it will not be criticised.

What then is a non-harmful tax regime?

So, having surveyed with a pretty broad brush what has happened to different groups of countries, and outlined the 2004 Progress Report, can one finally identify what is a non-harmful tax regime?

We can see that it seems acceptable to have a generalised, corporate tax rate which applies to all companies, even if it is at a low rate – 12.5% in Ireland, 10% in Cyprus, and even down to 0% in Gibraltar, Estonia, the Channel Islands and the Isle of Man. It does mean, of course, that those jurisdictions have to look for other sources of revenue, and they are looking to sales taxes or VAT, property taxes and employment charges to raise government revenue to make up for the shortfall from corporate income tax. To that extent, they are shifting the tax base to less mobile targets.

Alongside a generalised regime, can a state still have a special regime for certain categories of companies or certain activities? The answer seems clearly to be, yes, for some regimes. Shipping is the clearest example. Many jurisdictions have a special shipping regime, generally a tonnage tax, and that seems to be unassailable. The Consolidated Application Note generally approves a shipping regime which avoids certain elements. Similarly, a special regime for fund management is acceptable, so long as it avoids certain harmful features. What about a special regime for local financial services or local utilities? Gibraltar tried that, but has found problems with the state aid rules in the EU.

Holding company regimes seem also to be acceptable, so long as they avoid certain features. Most EU countries and many of the OECD, non-EU countries have such regimes, and one would expect them to be allowed, because the regime often has a number of aspects which are clearly acceptable. For example, participation exemptions are now so widely available that it is hard to see those as in any way being harmful regimes. In Cyprus, the participation exemption even comes down to a 1% holding, and, if I have understood it correctly, the new Italian regime has no minimum holding for its participation exemption. It is necessary to avoid harmful aspects: you cannot exempt dividends and gains where the subsidiary is not engaged in real trading activities and paying real tax - an exemption for holdings in tax haven subsidiaries would not be acceptable.

The exemption method of relief for double taxation is also acceptable. Though there is a view that it is only the credit method that is really non-harmful, the exemption method is so widely practised that is unlikely that that would ever be regarded as harmful.

Absence of tax on capital gains can be perceived as part of the general tax system, and so if you exempt all capital gains, even gains on land or shares, that would be non-harmful. No-one has suggested that there is any requirement that you need to tax capital or tax estates in order to be non-harmful, so regimes that do not tax capital or estates are certainly within the acceptable parameters.

Turning to individual taxation, can you have a special regime for expatriates or non-domiciliaries – taxing them only on 50% of their income or only on local source income? The jury is out on those, but so many countries have those regimes that it is doubtful that they would ever be characterised as harmful, at least if they are limited in time. Then one wonders what is an acceptable time limit – maybe five or seven years. But perhaps lifetime preferential treatment for non-domiciliaries is going to be regarded as harmful and unacceptable.

Of course, you can have a special tax regime for real trading and industrial activities. Industrial development zones have always been regarded as in a separate category.

Following the Netherlands, the Antilles and Aruba, you can have a rulings practice provided it is limited to issues like arm's length pricing and advanced tax rulings. Again, the Consolidated Application Note gives guidance on what elements a ruling regime must avoid.

The one key factor you have to have in your tax system is effective exchange of information and transparency. So it is clearly harmful if you do not enter into tax information exchange agreements. Increasingly, the world is moving to recognise an actual active duty to gather information for purposes of exchange. Until recently, the OECD was split on this. The United Kingdom and Japan did not recognise that duty, so the rest of the OECD was isolated. Now the United Kingdom and Japan have fallen in line, and all OECD countries recognise a duty to gather information for the purposes of exchange. Banking secrecy must also give way both to criminal and civil tax investigations by other states.

Analysis and Conclusions

Does it all make sense? Of course not. If you start without a clear idea of what is harmful, what have you got? You have got 0% corporate tax rates being regarded as not harmful, whereas if you have different systems for different types of companies (except shipping, fund management etc), that is regarded as harmful. Some elements make sense – transparency and exchange of information. Increasingly, people are recognising that other elements do not make sense, and one is beginning to hear talk within the European Union of a need for a minimum effective corporate tax rate, with which places like Ireland, Cyprus, Estonia and Gibraltar would have to comply.

Where are we going? One view of the facts is that the campaigns have accelerated the race to the bottom rather than prevented it. The campaigns have also sanitised certain preferential regimes – removed their worst elements – while sanctioning their continued existence. We may start seeing some serious questions coming out of the Commission and the Primarolo Committee about where we are going.

Our timetable has changed. We are now looking at 2010 and 2011 for the full effect of these campaigns to be felt, though that again may be pushed later. But it does mean that the next five years are going to be crucial. Once the self-congratulation is over, one may see the European Commission and OECD summing up in the same way as I have on what has been achieved so far, coming to the same conclusion that it does not make sense, and looking again at what is going to be regarded as acceptable tax competition.

APPENDIX I

CONCLUSIONS OF THE ECOFIN COUNCIL MEETING

on 1 December 1997
concerning taxation policy
(98/C 2/01)

The Council held a wide-ranging debate in the light of the Commission communication entitled “A package to tackle harmful tax competition in the European Union”, which takes stock of a discussion initiated by the Commission at the informal meeting of Ministers for Economic Affairs and Finance in Verona in April 1996 and given more substantial shape at the informal meeting in Mondorf-les-Bains in September 1997.

That discussion concerned the need for coordinated action at European level to tackle harmful tax competition in order to help achieve certain objectives such as reducing the continuing distortions in the single market, preventing excessive losses of tax revenue or getting tax structures to develop in a more employment-friendly way.

In the light of that debate and in a spirit of comprehensiveness of approach, three areas were particularly highlighted: business taxation, taxation of savings income and the issue of withholding taxes on cross‹border interest and royalty payments between companies.

Following that debate, the Council and the Representatives of the Governments of the Member States, meeting within the Council, agreed to the Resolution on a code of conduct for business taxation set out in Annex 1;

The Council also:

- approved the text on taxation of savings set out in Annex 2,

- considered that the Commission should submit a proposal for a Directive on interest and royalty payments between companies,

- took note of the Commission's intention to submit rapidly two proposals for Directives on the subjects referred to in the first and second indents above,

- called on the Commission to submit to it each year, together with the report provided for in paragraph N of the code of conduct for business taxation, a progress report on work concerning taxation of savings and interest and royalty payments between companies,

- took note of the Commission's undertaking on fiscal State aid,

- called on the Commission to take forward its work on taxation, continuing to draw on the assistance of the Taxation Policy Group,

- took note of the following statements for the Council minutes:

  1. re Annex 1 (code of conduct)

     Certain Member States and the Commission consider that special tax arrangements for employees could come within the range of problems covered by the code. They accordingly consider that this question needs to be discussed within the Taxation Policy Group with a view to a possible extension of the code under the review procedure laid down in paragraph N.

     The Council and the Representatives of the Governments of the Member States, meeting within the Council, as well as the Commission note that standstill and rollback are closely inter-related and stress the need for a balanced application to comparable situations, without this delaying the implementation of standstill and rollback. They also consider that a period of two years, as a general rule, should be sufficient for rollback. As from 1 January 1998 the actual rollback will have to take place within five years although a longer period may be justified in particular circumstances following an assessment by the Council.

     The German delegation, like other

delegations, understands point B (3) as including, *inter alia*, the targeted granting of advantages for international mobile activities, where they are not granted for non-mobile activities.

The Commission points out that the authorization granted in 1987 and extended most recently in 1994 for the arrangements for international financial services centres in Dublin expires in 2005 and that, under that authorization, no new institutions may benefit from those arrangements after 2000.

2. re Annex 2 (taxation of savings)

The Member States state that, if they were to change their legislation, they should be guided by the points set out in Annex 2 to these conclusions.

The United Kingdom delegation considers that such a Directive should not apply to Eurobonds and similar instruments.

The French delegation considers that the Directive on the taxation of savings should not lay down a rate of withholding tax of less than 25%.

The Netherlands delegation notes that it will assess the proposals in the light of the principle of taxation of savings in the country of residence.

The Luxembourg delegation considers that a Directive on taxation of savings should be accompanied by a Directive on business taxation covering general arrangements for business taxation in the Member States.

The Belgian, Italian and Portuguese delegations state that they will not agree to the Directive on interest and royalty payments between companies before the Directive on the taxation of savings is adopted.

3. The Commission notes the Netherlands delegation's request concerning problems relating in particular to taxation of pensions and insurance benefits; it undertakes to consider the matter with the assistance of the Taxation Policy Group with a view to possibly drawing up a proposal for a Directive.

4. The Commission notes the Belgian delegation's request concerning VAT treatment of cross-border motor vehicle leasing and undertakes to look into it with an open mind. It will in particular consider to what extent the proposals already planned to modernize and streamline the present VAT arrangements can provide a suitable solution.

ANNEX 1

RESOLUTION OF THE COUNCIL AND THE REPRESENTATIVES OF THE GOVERNMENTS OF THE MEMBER STATES, MEETING WITHIN THE COUNCIL

of 1 December 1997
on a code of conduct for business taxation

THE COUNCIL OF THE EUROPEAN UNION AND THE REPRESENTATIVES OF THE GOVERNMENTS OF THE MEMBER STATES, MEETING WITHIN THE COUNCIL,

RECALLING that a comprehensive approach to taxation policy was launched, at the Commission's instigation, at the informal meeting of the Ministers for Economic Affairs and Finance held in Verona in April 1996 and confirmed at the meeting in Mondorf-les-Bains in September 1997 in the light of the consideration that coordinated action at European level is needed in order to reduce continuing distortions in the single market, prevent significant losses of tax revenue and help tax Structures develop in a more employment-friendly way,

ACKNOWLEDGING the major contribution made by the Taxation Policy Group to the preparation of this Resolution,

NOTING the Commission communication to the

Council and the European Parliament of 5 November 1997,

ACKNOWLEDGING the positive effects of fair competition and the need to consolidate the competitiveness of the European Union and the Member States at international level, whilst noting that tax competition may also lead to tax measures with harmful effects,

ACKNOWLEDGING, therefore, the need for a code of conduct for business taxation designed to curb harmful tax measures,

EMPHASIZING that the code of conduct is a political commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty,

HEREBY ADOPT THE FOLLOWING CODE OF CONDUCT:

Code of conduct for business taxation tax measures covered

A. 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.

Business activity in this respect also includes all activities carried out within a group of companies.

The tax measures covered by the code include both laws or regulations and administrative practices.

B. 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.

When assessing whether such measures are harmful, account should be taken of, *inter alia:*

1. whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents, or

2. whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base, or

3. whether advantages are granted even without any real economic activity and substantial economic presence within the

Member State offering such tax advantages, or

4. whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD, or

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

Standstill and Rollback

Standstill

C. Member States commit themselves not to introduce new tax measures which are harmful within the meaning of this code. Member States will therefore respect the principles underlying the code when determining future policy and will have due regard for the review process referred to in paragraphs E to I in assessing whether any new tax measure is harmful.

Rollback

D. Member States commit themselves to re-examining their existing laws and established practices, having regard to the principles underlying the code and to the review process outlined in paragraphs E to I. Member States will amend such laws and practices as necessary with a view to eliminating any harmful measures as soon as possible taking into account the Councils discussions following the review process.

Review process

Provision of relevant information

E. In accordance with the principles of transparency and openness Member States will inform each other of existing and proposed tax measures which may fall within the scope of the code. In particular, Member States are called upon to provide at the request of another Member State information on any tax measure which appears to fall within the scope of the code. Where envisaged tax measures need parliamentary approval, such information need not be given until after their announcement to Parliament.

Assessment of harmful measures

F. Any Member State may request the opportunity to discuss and comment on a tax measure of another Member State that may fall within the scope of the code. This will permit an assessment 10 be made of whether the tax measures in question are harmful, in the light of the effects that they may have within the Community. That assessment will take into account all the factors identified in paragraph B.

G. The Council also emphasizes the need to evaluate carefully in that assessment the effects that the tax measures have on other Member States, *inter alia* in the light of how the activities concerned are effectively taxed throughout the Community.

Insofar as the tax measures are used to support the economic development of particular regions, an assessment will be made of whether the measures are in proportion to, and targeted at, the aims sought. In assessing this, particular attention will be paid to special features and constraints in the case of the outermost regions and small islands, without undermining the integrity and coherence of the Community legal order, including the internal market and common policies.

Procedure

H. A group will be set up by the Council to assess the tax measures that may fall within the scope of this code and to oversee the provision of information on those measures. The Council invites each Member State and the Commission to appoint a high-level representative and a deputy to this group, which will be chaired by a representative of a Member State. The group, which will meet regularly, will select and review the tax measures for assessment in accordance with the provisions laid down in paragraphs E to G. The group will report regularly on the measures assessed. These reports will be forwarded to the Council for deliberation and, if the Council so decides, published.

I. The Council invites the Commission to assist the group in carrying out the necessary preparatory work for its meetings and to facilitate the provision of information and the review process. To this end, the Council requests Member States to provide the Commission with the information referred to in paragraph E so that the Commission may coordinate the exchange of such information between the Member States.

State aid

J. The Council notes that some of the tax measures covered by this code may fall within the scope of the provisions on State aid in Articles 92 to 94 of the Treaty. Without prejudice to Community law and the objectives of the Treaty, the Council notes that the Commission undertakes to publish guidelines on the application of the State aid rules to measures relating to direct business taxation by mid- 1998, after submitting the draft guidelines to experts from the Member States at a multilateral meeting, and commits itself to the Strict application of the aid rules concerned, taking into account, inter alia, the negative effects of aid that are brought to light in the application of this code. The Council also notes that the Commission intends to examine or re-examine existing tax arrangements and proposed new legislation by Member States case by case, thus ensuring that the rules and objectives of the Treaty are applied consistently and equally to all.

Action to combat tax avoidance and evasion

K. The Council calls on the Member States to cooperate fully in the fight against tax avoidance and evasion, notably in the exchange of information between Member States, in accordance with their respective national laws.

L. The Council notes 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.

Geographical extension

M. The Council considers it advisable that principles aimed at abolishing harmful tax measures should be adopted on as broad a geographical basis as possible. To this end. Member States commit themselves to promoting their adoption in third countries; they also commit themselves to promoting their adoption in territories to which the Treaty does not apply.

In particular, Member States with dependent or associated territories or which have special responsibilities or taxation prerogatives in respect of other territories commit themselves, within the framework of their constitutional arrangements, to ensuring that these principles are applied in those territories. In this connection, those Member States will take stock of the situation in the form of reports to the group referred to in paragraph H, which will assess them under the review procedure described above.

Monitoring and revision

N. In order to ensure the even and effective implementation of the code, the Council invites the Commission to report to it annually on the implementation thereof and on the application of fiscal State aid. The Council and the Member States will review the provisions of the code two years after its adoption.

APPENDIX II

PRIMAROLO COMMITTEE LIST OF MEASURES WITH HARMFUL FEATURES (66)

(i) Member States (40)

Austria AAM002b: Holdings (Schachtelbegünstingung-Intra Group Relief)
Austria EAM009: Tax Exemptions
Belgium A001: Co-ordination Centres
Belgium A002: Distribution Centres
Belgium A003: Service Centres
Belgium E001: US Foreign Sales Companies Ruling
Belgium E002: Informal Capital Ruling
Denmark AAM021: Holding Companies
Finland B008: Åland Islands Captive Insurance
France A006: Headquarters and Logistic Centres

France A012: Royalty Income - Patents
France CAM058 Provisions for Renewal of Mineral Reserves
France CAM059: Provision for Renewal of Oil and Gas Reserves
Germany AAM019: Control and Coordination Centres of Foreign Companies in Germany
Greece B011: Offices of Foreign Companies under the Law 89/67
Ireland * B001: The International Financial Services Centre (Dublin)
Ireland * C024: 10% Manufacturing Rate
Ireland **** C025: Petroleum Taxation
Ireland * D017 Shannon Airport Zone (SAZ)
Ireland E007: Foreign Income
Italy *** B002: Trieste Financial Services and Insurance Centre
Luxembourg ** A007: Co-ordination Centres
Luxembourg A0013: 1929 Holding Companies
Luxembourg ** B003: Luxembourg Finance Companies
Luxembourg B007: Provisions for fluctuations in reinsurance
Luxembourg Z002: Finance Branches
Netherlands A008: Cost Plus Ruling
Netherlands A009: Resale Minus Ruling
Netherlands A010: Intra Group Finance Activities
Netherlands A014: Holding Companies
Netherlands A015: Royalties
Netherlands B004: International Financing Activities
Netherlands B005: Finance Branch

Netherlands E003: US Foreign Sales Companies Ruling
Netherlands E004: Informal Capital Ruling
Netherlands Z003: Non Standard Rulings (including Greenfield-rulings)
Portugal * B006: Madeira and Sta Maria (Azores) Free Zones
Spain A004: Basque Country Co-ordination Centres
Spain A005: Navarra Co-ordination Centres
Spain CAM025: Investigation and Exploitation of Hydrocarbons

* Measures time limited or being phased out …
** Measures abolished, benefits being phased out ….
*** Not operational ….
**** Measure will, from January 2000, no longer apply a lower rate than the generally applicable rate

(ii) European territories for whose external relations a Member State is responsible under Article 299.4 of the EC Treaty. (3)

UK: Gibraltar A017: Gibraltar 1992 Companies
UK: Gibraltar B012: Exempt (offshore) Companies and Captive Insurance
UK: Gibraltar B013: Qualifying (offshore) Companies and Captive Insurance

(iii) Dependent or associated territories (23)

Aruba F027: Offshore Companies
Aruba F028: Exempt Companies (AVVs)
Aruba F030: Free Zones
Aruba F032: Captive Insurance

British Virgin Islands F056: International Business Companies
Guernsey (incl Alderney) F037: Exempt Companies
Guernsey (incl Alderney) F038: International Loan Business
Guernsey (incl Alderney) F040: International Bodies
Guernsey (incl Alderney) F042: Offshore Insurance Companies
Guernsey (incl Alderney) F043: Insurance Companies
Isle of Man F061: International Business Companies
Isle of Man F062: Exemption for Non Resident Companies
Isle of Man F063: Exempt Insurance Companies
Isle of Man F065: International Loan Business
Isle of Man F066: Offshore Banking Business
Isle of Man F067: Fund Management
Jersey F045: Tax Exempt Companies
Jersey F046: International Treasury Operations
Jersey F047: International Business Companies
Jersey F048: Captive Insurance Companies
Netherlands Antilles F020: Offshore Companies
Netherlands Antilles F023: Captive Insurance
Netherlands Antilles F024: Free Zones

APPENDIX 3

OECD 2004 Progress Report

Table of Conclusions Reached on Potentially Harmful Regimes Identified In 2000

Country	Regimes	Abolished	Continuing Regimes		
			Amended to remove potentially harmful features	Not Harmful	Harmful

Insurance

Australia	Offshore Banking Units			√	
Belgium	Co-ordination Centres	√			
Finland	Aland Captive Insurance Regime	√			
Italy	Trieste Financial Services and Insurance Centre	√			
Ireland	International Financial Services Centre	√			
Portugal	Madeira	√			

	International Business Centre				
Luxembourg	Provisions for Fluctuations in Reinsurance Companies		√		
Sweden	Foreign Non-Life Insurance Companies	√			

Financing and Leasing

Belgium	Co-ordination Centres	√			
Hungary	Venture Capital Companies			√	
Hungary	Preferential Regime for Companies Operating Abroad	√			
Iceland	International Trading Companies	√			
Ireland	International Financial Services Centre	√			
Ireland	Shannon Airport Zone	√			
Italy	Trieste Financial Services and Insurance	√			

	Centre				
Luxembourg	Finance Branch		√		
Netherlands	Risk Reserves for International Group Financing	√			
Netherlands[6]	Intra-Group Finance Activities		√		
Netherlands	Finance Branch		√		
Spain	Basque Country and Navarra Coordination Centres	√			
Switzerland	50/50 Practice[7]				

Fund Managers

Greece	Mutual Funds/Portfolio Investment Companies [Taxation of Fund Managers]			√	
Ireland	International Financial Services Centre [Taxation of Fund Managers]	√			
Luxembourg	Management companies				

	[Taxation of management companies that manage only one mutual fund (1929 holdings)]				
Portugal	Madeira International Business Centre [Taxation of Fund Managers]	√			

Banking

Australia	Offshore Banking Units			√	
Canada	International Banking Centres			√	
Ireland	International Financial Services Centre	√			
Italy	Trieste Financial Services and Insurance Centre	√			
Korea	Offshore Activities of Foreign Exchange Banks	√			
Portugal	External	√			

	Branches in the Madeira International Business Centre				
Turkey	Istanbul Offshore Banking Regime	√			

Headquarters regimes

Belgium	Co-ordination Centres	√			
France	Headquarters Centres		√		
Germany	Monitoring and Co-ordinating Offices		√		
Greece	Offices of Foreign Companies	√			
Netherlands	Cost-plus Ruling		√		
Portugal	Madeira International Business Centre	√			
Spain	Basque Country and Navarra Coordination Centres	√			
Switzerland	50/50 practice				
Switzerland	Service Companies		√		

Distribution Centre Regimes

Belgium	Distribution Centres		√		
France	Logistics Centres		√		
Netherlands	Cost-plus/Resale Minus Ruling		√		
Turkey	Turkish Free Zones			√	

Service Centre Regimes

Belgium	Service Centres		√		
Netherlands	Cost-Plus Ruling		√		

Shipping

Canada	International Shipping			√	
Germany	International Shipping			√	
Greece	Shipping Offices			√	
Greece	Shipping Regime (Law 27/75)			√	
Italy	International Shipping			√	
Netherlands	International Shipping			√	
Norway	International			√	

	Shipping				
Portugal	International Shipping Register of Madeira			√	

Miscellaneous Activities

Belgium	Ruling on Informal Capital		√		
Belgium	Ruling on Foreign Sales Corporation Activities	√			
Canada	Non-resident Owned Investment Corporations	√			
Netherlands	Ruling on Informal Capital		√		
Netherlands	Ruling on Foreign Sales Corporation Activities	√			
United States	Foreign Sales Corporations	√			

[1] This is the text of a talk originally delivered to the International Tax Planning Association in June 2003 in Hamburg. It has been updated and revised to include material available as at April 2004,

particularly the 2004 Progress Report of The OECD's Project on Harmful Tax Practices (OECD, Paris, March 2004).

[2] Andorra, Liberia, Liechtenstein, the Marshall Islands and Monaco.

[3] Directive 2003/48/EC.

[4] The OECD 2004 Report notes that the Icelandic International Trading Company regime, the Netherlands Risk Reserve regime and the Madeira International Business Centre regime are to be ended in 2008, 2010 and 2011 respectively, but no new entrants are to be admitted to these regimes.

[5] See the draft EU Council Decision on the Conclusion of an Agreement between the European Community and the Swiss Confederation, COM (2004) 75 final of 10th February 2004.

[6] The Netherlands has replaced this regime with an Advance Pricing Agreement/Advance Tax Ruling practice.

[7] In the 2000 Report these were referred to as administrative companies. The 50/50 practice will be subject to further analysis.