



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

A package to tackle harmful tax competition in the European Union

TOWARDS TAX CO-ORDINATION IN THE EUROPEAN UNION

1. On the basis of the Commission's Communication of 1 October 1997¹, the ECOFIN Council held an orientation debate on taxation at its meeting of 13 October. The Commission was invited to present refined proposals for a package to combat harmful tax competition as a basis for a political agreement at the 1 December ECOFIN meeting.
2. The global approach to taxation policy was launched at the informal ECOFIN meeting in Verona in April 1996. This approach recognises that co-ordinated action at the European level is needed in order to reduce distortions to the Single Market; to prevent significant losses of tax revenue; and to help tax structures to develop in a more employment-friendly way, notably by reversing the trend of an increasing tax burden on labour as compared with more mobile tax bases. This is in line with the Action Plan for the Single Market², which seeks to remove market distortions, to create a common system for VAT and to restructure the Community framework for the taxation of energy products. In Verona, Finance Ministers endorsed this global approach and asked a High Level Group of their personal representatives, chaired by the Commission, to take forward the analysis.
3. The High Level Group met between June and October 1996, and greatly assisted the Commission in the preparation of its Communication of 22 October 1996³. That Communication underlined the need for a permanent group to co-ordinate tax policies within the European Union - the Taxation Policy Group (TPG) - and drew attention to the need for further work, notably on harmful tax competition. This approach was endorsed by the Dublin European Council⁴.

¹ "Towards Tax Co-ordination in the European Union", COM(97) 495

² CSE(97)1 of 4 June 1997

³ "Taxation in the European Union, Report on the Development of Tax Systems", COM(96) 546

⁴ Presidency Conclusions, SN 401/96

4. The TPG, which brings together personal representatives of Finance Ministers under Commission chairmanship, began its work in March 1997. Within the context of the global approach and in view of better co-ordination of tax policies within the Union, the Group has concentrated on developing a package of measures targeted primarily at tackling the issues of harmful tax competition. The approach was first debated at the informal meeting of Finance Ministers in Mondorf-les-Bains on 13 September and subsequently, on the basis of the Commission's Communication of 1 October, at the 13 October ECOFIN Council.
5. The adoption and implementation of a balanced tax package could increase the room for manoeuvre in rendering taxation systems more conducive to employment. For this reason, the Commission intends to include this aspect in its submission to the special European Council on employment on 20-21 November.

A PACKAGE TO TACKLE HARMFUL TAX COMPETITION

6. Since Verona, the progress towards achieving a more co-ordinated approach to taxation policy within the Union has been considerable. The Commission, recognising the need to avoid any suggestion that the respective competences should be disturbed, has sought to co-operate extensively with Member States in this process. The package outlined below is therefore proposed solely on the authority of the Commission but has drawn extensively on this co-operation. Some Member States have made it clear that they looked for a more ambitious package, but extensive debate within the Council and the TPG has shown that, at present, this is not attainable given the initial reluctance of others to consider any move towards tax co-ordination. Against this background, the Commission considers that the package now proposed would be a major step forward towards greater co-ordination and in the effort to combat harmful tax competition in the Union. Moreover, the Commission believes that the package offers the real prospect of agreement between Member States, provided that the spirit of compromise witnessed over the past eighteen months is maintained.

7. The package offers a better prospect of agreement than is possible if each policy issue is tackled separately. Nevertheless, the balancing of a wide range of differing interests will involve compromise on all sides. However, that there is a political engagement to make such progress is undeniable. It was confirmed by the Amsterdam European Council. The Council is now invited to grasp the present opportunity to make progress in this area and to signal that it is willing to act decisively in areas where Community action can reduce the burden of taxation on labour.
8. The Commission has reviewed the elements which it put forward on 1 October and proposes a package with the following three components:
 - a code of conduct for business taxation;
 - measures to eliminate distortions to the taxation of capital income;
 - measures to eliminate withholding taxes on cross-border interest and royalty payments between companies.

The Commission invites the Council to give a political commitment to this package on 1 December, and to keep its implementation under periodic review thereafter.

9. On the *code of conduct for business taxation* (for which a draft is attached in Annex 1), the Commission invites the Member States to commit themselves at a political level to respect principles of fair competition and to refrain from tax measures that cause harmful competition. In order to ensure its effectiveness, it will be implemented through a "follow-up" mechanism and will be subjected to a review after two years of operation. Although this text is put forward on its own authority, the Commission would again like to acknowledge the considerable debt that it owes to the co-operative efforts of the Member States in the Council and in successive meetings of the Taxation Policy Group. The Commission invites the Council to adopt a resolution incorporating the code of conduct.

10. There is a widely-shared desire on the part of Member States to make significant progress in the area of the *taxation of capital income from savings*. Although there are signs of positive movement in this area, discussions have revealed that some substantial difficulties which have hampered progress in the past persist. The Commission fully recognises the problem that such concerns present. Nevertheless, the Commission considers that Member States would contribute significantly towards progress by agreeing certain elements on which a subsequent Commission proposal for a minimum solution would be based. To this end, the Commission proposes in Annex 2 to this Communication five elements on which a Directive might be based. Member States are invited to endorse these elements as a basis for the Commission to prepare a draft proposal for a Directive by April 1998. Member States are also invited to agree to work actively to allow the early adoption of the Commission proposal based on these elements.
11. On *interest and royalty payments between companies*, withholding taxes create difficulties for economic operators engaged in cross-border business. They can involve time-consuming formalities, result in cash flow losses, and sometimes lead to double taxation. As part of the package, the Commission invites the Member States to make a political commitment to work towards the early adoption of a directive for which the Commission will make a new proposal by February 1998.
12. The Commission stresses that the package put forward above is to be seen in the broader context, as noted in the Action Plan for the Single Market, and as further developed by the TPG. It notes, in particular, the support that exists for making progress within the TPG on many of the *indirect taxation* elements identified in its Communication of 1 October, and recognises in particular that the issue of VAT on cross-border leasing merits action that is no less urgent than the package.
13. The Commission appreciates the wish expressed by Member States for a commitment by the Commission in relation to *fiscal state aids* to accompany the endorsement of the package and the code of conduct in particular. Member States will be aware that the Commission has already begun its review of certain cases and is continuing to reflect on these issues in order to come forward with an indication of its position following a discussion in the College on 19 November. This will serve as a basis for the normal consultations with Member States on guidelines in this area, which will be conducted in parallel with the implementation of the package outlined above.

CONCLUSION

14. The Council is requested

- to endorse the package set out in this Communication, with a commitment to keep its implementation under periodic review;
- to adopt the code of conduct for which a draft Council resolution is contained in Annex 1;
- to endorse the elements for a minimum Community solution on the taxation of income from savings as outlined in Annex 2;
- to make a political commitment to work towards early adoption of a Directive on interest and royalty payments between companies on the basis of a forthcoming Commission proposal;
- to take note of the Commission's commitment on fiscal state aids; and
- to give its support to the work on the other issues mentioned in paragraph 12.

DRAFT RESOLUTION ON A CODE OF CONDUCT FOR BUSINESS TAXATION***POLITICAL COMMITMENT***

- A. While recognising the positive effects of fair competition, and the need to maintain world-wide competitiveness, the Council notes that unrestrained tax competition for mobile forms of business increasingly threatens to cause economic distortions and to erode tax bases within the Community. It underlines its concern, especially in relation to measures that provide operating support to international finance and services activities. The Council condemns the use of tax measures that harm the Community interest, including the effective operation of the Single Market, and it accordingly encourages Member States neither to introduce nor to retain such measures.
- B. To this end, the Council requests the Member States to adopt and implement the following Code of conduct. This Code, which is wholly without prejudice to the application of Community law, identifies tax measures that are potentially harmful and provides a framework within which Member States can commit themselves to follow the principles of fair competition. The Code fully respects the principle of subsidiarity, and does not affect the respective competences of the Member States and the Commission.

SCOPE***Taxes covered***

- C. This Code covers those business tax measures which affect, or which may affect, in a significant way the location of business activity in the Community. Business activity in this respect includes all activities carried out within a group of companies. The Code also covers those special tax regimes for employees which have, or which may have, a significant effect on the location of business activity. The tax measures covered by the Code include legislative provisions, regulations and administrative practices.

Identifying potentially harmful tax measures

D. Within the field of application specified in §C, the Council recognises as being potentially harmful those tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than that which generally applies in the Member State in question. Such regimes, which may operate by virtue of the nominal tax rate, by virtue of the tax base, or otherwise, will in addition be evaluated in the light of one or more of the following characteristics:

- (i) whether particular benefits are given only to non-residents of the Member State in question, or are given only in respect of transactions carried out with non-residents;
- (ii) whether benefits are otherwise ring-fenced from the domestic market of a Member State so they do not affect the national tax base;
- (iii) whether benefits are available without there being any real economic activity;
- (iv) whether the basis of profit determination in respect of activities within a multinational group of companies departs from internationally-accepted principles, notably those agreed upon within the OECD;
- (v) whether the measure lacks transparency, including where statutory rules are relaxed at administrative level in a non-transparent way.

STANDSTILL AND ROLLBACK

Standstill

E. Member States commit themselves not to introduce new tax measures which are harmful to the Community interest, including the effective operation of the Single Market. Member States will therefore respect the principles underlying the code when determining future policy, and will have particular regard to the Review Process outlined in §G-K below in assessing whether any new tax measures or practices are harmful.

Rollback

- F. Member States commit themselves to re-examine their existing laws and established practices, having regard to the principles underlying the Code and to the Review Process outlined in §G-K below. Member States will amend such laws and practices as necessary, with a view to eliminating any harmful measures. Any such measures should, as a general rule, be eliminated within two years, although a longer period may be justified in particular circumstances, taking into account the reasonable expectations of business.

REVIEW PROCESS

Provision of information

- G. In accordance with the principles of transparency and openness, Member States will inform each other of existing and proposed tax measures which fall within the scope of the Code as described at §C-D above. In addition, Member States may seek information from other Member States on any tax measure which appears to fall within the scope of the Code. Where proposed measures need parliamentary approval, such information may be given after their announcement to Parliament.

Assessment of harmful measures

- H. Any Member State may request the opportunity to discuss and comment on a tax measure of another Member State that falls within the scope of the Code. This will permit an assessment to be made of whether such measures are harmful, in the light of the effects that they may have within the Community. That review will take into account all the factors identified in §D above, and, in assessing the impact of tax measures on business location, the effective levels of taxation on the same economic activity that are applied throughout the Community.
- I. In reviewing tax measures, the Council emphasises the need to assess carefully the effects which they have on other Member States; and, in so far as they are used to support the economic development of particular areas, to evaluate the extent to which the measures are effective in achieving their aims.

Procedure

- J. A Group will be established by the Council to oversee the provision of information on, and assessment of, tax measures that fall within the scope of this Code. The Council invites each Member State and the Commission to appoint a high level representative and a deputy to this Group. The Group, which will meet as necessary, will select and review the tax measures for assessment under §G-I. A report by the Group of the review of each measure will be transmitted to the Council for its consideration and, if the Council so decides, for publication.
- K. The Council invites the Commission to provide assistance to the Group in carrying out the necessary preparatory work for its meetings, and to facilitate the provision of information and assessment process. To this end, the Council requests Member States to provide to the Commission the information referred to in §G so that the Commission may co-ordinate its exchange between the Member States.

STATE AIDS

- L. The Council notes that some, although not all, of the tax measures covered by this Code fall within the scope of the provisions on state aid in Articles 92-94 of the EC Treaty. Without prejudice to Community law, the Council notes that the Commission undertakes to provide guidance on the application of the state aid rules to fiscal aids, and commits itself to the rigorous application of the state aid rules, taking into account, *inter alia*, negative effects of aid that are brought to light in the application of this Code.

ANTI-AVOIDANCE AND TAX EVASION

- M. The Council stresses its commitment to full co-operation in the fight against tax evasion and avoidance, notably in the provision of information to other Member States in accordance with national legislation.
- N. 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. Member States should apply such measures in accordance with Community law.

GEOGRAPHICAL EXTENSION

- O. The provisions of this Code will apply within the Community. Furthermore, the Council considers that it would be beneficial that the principles supporting fair competition be adopted as widely as possible. To this end Member States will promote their adoption at an international level, and in particular will give active support to their adoption in their dependent or associated territories.

MONITORING AND REVISION

- P. In order to ensure the even and effective implementation of the Code, the Council invites the Commission to report to it annually. The Council shall also review the provisions of the Code when it has been in operation for two years.

**ELEMENTS FOR A MINIMUM COMMUNITY SOLUTION
IN THE AREA OF THE TAXATION OF SAVINGS**

With a view to preparing possible Community legislation in this area, the Member States are invited to confirm their agreement that the following elements can together form a basis for a Commission proposal:

- I. A common solution is needed in order to prevent undesirable distortions of competition. Agreement on a minimum solution in the form of a directive is preferable to the continuation of the current situation, which entails tax avoidance, erosion and a loss of revenue.
- II. The scope of this Directive should be limited to interest paid in one Member State to individuals who are not resident for tax purposes in that State but who are resident in another Member State, in order to focus primarily on redressing the possible non-taxation of non-residents.
- III. The proposed Directive should be based on the so-called "co-existence model". Under such a model each Member State will operate either a minimum withholding tax or provide information on savings income to other Member States, in order to ensure at least some effective taxation of non-residents' income from savings within the Community. A Member State may combine the elements.
- IV. Any withholding tax on interest payments made to residents of other Member States will, in principle, be levied by the paying agent. Refinement of this method might be needed in order to counter tax avoidance and evasion more effectively and to avoid double taxation. The arrangements for checking the fiscal residence of beneficiaries will not be cumbersome.
- V. The provisions of the Directive will take into account the need to preserve the competitiveness of European financial markets in a global context. The elements described above should be adopted as widely as possible. To this end Member States will promote their adoption at an international level, and in particular will give active support to their adoption in their dependent or associated territories.

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