European Finance Ministers approve a revised Code of Conduct for Business Taxation

14 November 2022

In brief

While meeting for the monthly ECOFIN meeting on 8 November, the European Member States' Finance Ministers agreed to revised text to the European Code of Conduct for Business Taxation. The Code of Conduct plays an important role in determining which tax regimes are assessed for purposes of the EU list of non-cooperative jurisdictions for tax purposes.

The revision extends the scope of the Code of Conduct to cover both preferential tax measures and tax features of general application (referred to as 'tax measures') which affect, or may affect, in a significant way the location of business activity in the Union. The latter element, the general features of a regime, is new and will assess whether that general feature leads to lower tax liability, including no tax liability, other than the nominal tax rate or deferred taxation as a feature of a distribution tax system. The additional measures in the Code of Conduct will apply from 1 January 2023.

In detail

Background and operation of the Code of Conduct Group

Reform of the Code of Conduct for Business Taxation has been an agenda item for both the EU Council and the EU Parliament for some time. The original Code of Conduct was adopted in 1997, giving powers to a group who later became known as the Code of Conduct Group ('the Group') to assess harmful tax measures that might exist in EU Member States. The Group's remit was later extended to cover non-EU countries. The Group is best-known for the twice yearly publication of the EU list of non-cooperative jurisdictions for tax purposes (latest version available here).

This list illustrates which countries have tax regimes considered to be harmful to EU Member States, and notwithstanding calls from the Group to amend the regime, have not taken sufficient steps to remove the harmful element of the regime, or repeal the regime. The countries listed are commonly known as 'blacklist' or 'greylist' countries. There are consequences of being a listed country, including the imposition of withholding tax on

payments from EU Member States to such countries. Additional reporting requirements also will soon apply under public country-by-country reporting rules.

Harmful tax measures

The original Code of Conduct provided that "those measures which affect, or may affect, in a significant way the location of business activity in the Community" and "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" would be regarded as being potentially harmful. The harmful feature could be the nominal rate of tax in that country, an aspect of the tax base, or any other relevant factor.

To date, the Group has focused its assessment on harmful preferential tax regimes and has determined that many such preferential regimes were or are harmful. A number of such regimes have been amended or repealed to remove the harmful element, generally in response to the country being listed, or the threat of a potential listing. Some harmful regimes continue to exist, resulting in twelve countries currently being 'blacklisted' by the Group.

Observation: In October 2021, the EU Parliament ('EP') voted in favour of a proposal to reform the Code of Conduct. The EPs felt there should be a move away from reviewing preferential tax regimes, to look at "aggressive" tax regimes of countries more generally. Reviewing the general aspects of a regime might focus on, for example, special citizenship regimes or other income incentives to attract mobile wealthy individuals. There was also a recommendation in an EU Parliament report that the key criteria to be assessed under the Code of Conduct would be the country's effective tax rate, aligned to the work on Pillar Two, along with robust and progressive economic substance requirements. The proposals were overwhelmingly supported by EU MEPs, but a later vote about whether to reform the Code of Conduct at the December 2021 ECOFIN meeting was ultimately not unanimously supported by all EU Finance Ministers. The Finance Ministers asked the Group to continue working on proposals to reform the Code of Conduct. In a recent own initiative report by the EU Parliament FISC-subcommittee, it was recommended that the scope of the Code be expanded to include preferential personal income or capital tax regimes, or personal income and wealth tax regimes that could lead to significant distortions in the single market. These recommendations did not feature in the revision that was approved by the EU Finance Ministers.

Agreement on a revised Code of Conduct

The agreement now reached by the EU Finance Ministers takes the form of a Council Resolution. The key changes are as follows:

- Tax features of general application which affect, or may affect, in a significant way the location of business activity in the Union will be assessable by the Group in determining whether harmful tax practices exist in that country.

- For a measure to be assessed, it must lead to a lower tax liability, other than the nominal tax rate (or no tax liability at all), or to deferred taxation as a feature of a distribution tax system.

- In assessing whether the features of general application are harmful, the Group will consider:

    1. Does the tax feature lead to double non-taxation or does it allow the double or multiple use of tax benefits in connection with the same expenses, amount of income or chain of transactions, because it is not accompanied by appropriate anti-abuse provisions or other adequate safeguards?

    2. Does this affect in a significant way the place of business activity in the Union? The Group should account for the fact that the location of business activity can also be influenced by circumstances other than tax features in making the assessment.

- There must be a direct causal link between 1 and 2.
- The review of general tax measures will only be used for measures enacted or modified on or after 1 January 2023.

Observation: Our interpretation of the entrance criteria is that a deferral under a distribution tax system, like Estonia has, will not lead to the assessment of a tax measure by default. It remains to be seen what elements of countries' tax regimes will ultimately be assessable against the additional criteria for general tax measures. It is interesting that the Council has agreed, regarding the first consideration above, to significantly pared-back criteria (focused on double non-taxation or double or multiple use of tax benefits in connection with the same expenses, amount of income or chain of transactions not covered by sufficient anti-tax avoidance rules), rather than the more expansive proposal suggested one year previously. It is expected this reflects a political compromise of EU Finance Ministers.

The revised Code of Conduct replaces the 1997 original version from 1 January 2023.

The takeaway

While the Group will continue to assess countries on the basis of objective criteria in relation to tax transparency, fair taxation, and implementation of anti-BEPS measures, the revision of the Code of Conduct will ultimately impact how countries' tax regimes are assessed for the purposes of determining whether they might be 'blacklisted' or 'greylisted'. This revision does not go as far as it might have to encompass more general features of tax regimes, but it represents a shift towards examination of favourable tax regimes more generally.

Let's talk

For a deeper discussion of how the proposal might affect your business, please contact:

Tax policy leadership

Stef van Weeghel, *Amsterdam*
+31 0 88 7926 763
stef.van.weeghel@pwc.com

Will Morris, *Washington*
+1 202 213 2372
william.h.morris@pwc.com

Edwin Visser, *Amsterdam*
+31 0 88 7923 611
edwin.visser@pwc.com

Tax policy editors

Phil Greenfield, *United Kingdom*
+44 (0) 7973 414 521
philip.greenfield@pwc.com

Chloe O'Hara, *Ireland*
+353 (0) 87 7211 577
chloe.ohara@pwc.com

Keetie van der Torren-Jakma, *Netherlands*
+31 6 1856 5973
keetie.van.der.torren-jakma@pwc.com

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