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Global Tax Alert

European Commission publishes communication on intensifying the work on tax transparency and harmful tax competition by means of advocating Tax Good Governance in the EU and beyond

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Executive summary

On 15 July 2020, the European Commission (the Commission) published a communication on Tax Good Governance in the European Union (EU) and beyond (the Communication) which aims to further strengthen how the EU can promote transparency, address what it defines as unfair tax competition and promote the application of internationally agreed standards. In the Communication, the Commission proposes:

- Reform of the Code of Conduct for Business Taxation
- Review of the EU list of non-cooperative jurisdictions for tax purposes
- Promotion of Tax Good Governance through EU funds and strengthening of defensive measures against non-cooperative jurisdictions
- Additional support for developing country partners in enhancing tax good governance

The Communication is part of a tax package for fair and simple taxation supporting the recovery of the EU, which also includes an action plan that presents a number of upcoming initiatives in the field of direct and indirect taxation concerning the fight against tax fraud and the simplification of tax regimes, as well as a legislative proposal for revision of the Directive on administrative cooperation (DAC7).[1]

Building a better working world

Detailed discussion

Background

On 1 December 1997, the Council and representatives of the governments of the EU Member States adopted a resolution on a Code of Conduct for Business Taxation (the Code), with the objective of curbing harmful tax competition. As foreseen by the resolution, a Code of Conduct Group (COCG) was set up within the framework of the Council on 9 March 1998. Its role is to assess tax measures that may fall within the scope of the Code. The COCG is composed of high-level representatives of both Member States and the Commission. Since the Code was established, over 400 tax regimes have been assessed in the EU and around 100 of these were found to be harmful, i.e., they have to be amended or abolished. In addition to the Code's achievements within the EU, it has also had an impact on the global tax environment in recent years. This is because it has been the basis for assessing third countries in the context of the EU list.

On 5 December 2017, the Council published the first EU list, comprising 17 jurisdictions which were deemed to have failed to meet relevant criteria established by the Commission.[2] Principles of fair tax competition, set out in the Code, are among the criteria used to assess third countries under the EU listing process for non-cooperative jurisdictions (EU list).

The Council recommended Member States to consider applying one or more defensive measures, including both taxation and non-taxation measures, aimed at preventing the erosion of their tax bases. The suggested defensive measures in tax can be found in Annex III to the December 2017 Council conclusions[3] and in the guidance on defensive measures included in the COCG report of 25 November 2019.[4]

The Commission also published a communication in March 2018 including requirements against tax avoidance in EU legislation governing, in particular, financing and investment operations.[5] The said communication aims to ensure that EU external development and investment funds cannot be channeled or transited through entities in jurisdictions listed on the EU List.

Commission Communication on Tax Good Governance in the EU and Beyond

In the EU, Tax Good Governance has been the umbrella under which the EU has sought to fight harmful tax competition and create a level playing field on tax between EU countries and beyond. Broadly, Tax Good Governance is defined by the Commission as encompassing tax transparency, fair tax competition, the absence of harmful tax measures and the application of internationally agreed standards.

With the communication issued on 15 July 2020, the Commission aims to review progress made in enhancing Tax Good Governance in the EU but also externally and suggests areas for intensifying the work. The Commission is making the following concrete proposals:

1. **A reform of the Code, to ensure that the COCG can effectively tackle all forms of harmful tax competition in a more transparent manner.** This includes:

   i) *Timing the reform for maximum effect*: The Communication mentions that if minimum effective taxation becomes a global standard as part of the international discussions led by the Organisation for Economic Co-operation and Development (OECD), there may be an impact on the accepted limits of tax competition and the COCG will have to be reformed to boost EU actions on fair tax competition. If there is no consensus on minimum taxation at the global level, according to the Communication, this concept of minimum taxation may need to be introduced in the code as an EU standard.

   ii) *Reviewing the scope and criteria of the Code*: According to the Communication, the scope of the Code should be broadened beyond only looking at specific tax measures and regimes which are introduced by jurisdictions, to cover further types of regimes and general aspects of the national corporate tax systems which have the same effects as such specific regimes, such as for example exemptions of foreign income. The Commission also proposes to include relevant taxes other than corporate tax. The Commission encourages Member States to expand the scope to cover special citizenship schemes or measures to attract expatriates or wealthy individuals. In addition, the Commission proposes to update the Code to ensure that all cases of very low taxation are examined inside and outside of the EU, so that there is full coherence between the criteria applied within the EU and in relation to third countries.

   iii) *Improving the governance of the Code*: The Communication mentions that the COCG could make more information publicly available on its dedicated website and inform the public and stakeholders of its work. The Commission also proposes to consider

qualified majority voting within the COCG, with the aim to speed up decision-making. Finally, the Commission proposes the consideration of effective consequences for Member States that do not comply with the COCG's decisions on time.

2. **A review of the EU list of non-cooperative jurisdictions, to ensure that it is still effective, fit and fair to deal with today's challenges.** This includes:

   i) *Reviewing the geographical scope of the EU list*: According to the Communication, the Commission will update by the end of 2020 the original scoreboard used by the COCG to select the most relevant jurisdictions to screen under the EU listing process. The new scoreboard will reflect the most recent data, as well as developments in the global economy and tax policy. As a result, more jurisdictions may become subject to review by the COCG.

   ii) *Reviewing EU listing criteria*: The Commission proposes the review of the EU listing criteria in order to examine whether all criteria are relevant for all jurisdictions, based on the potential risk of their economic and tax environment. For low-risk developing countries, it could be an option to only apply the criteria that are most relevant or the EU list deadlines can be adapted for countries with severe capacity constraints or without financial centers. Also, discussions at the international level on taxation of the digital economy and global tax reform will also need to be taken into account in the EU listing criteria according to the Communication. The Commission also proposes to closely monitor the jurisdictions that have already been cleared under the EU listing process to ensure that the reforms are effectively implemented.

   iii) *Boosting transparency and accountability*: The Communication states that the Commission will work to establish an annual gathering for representatives of jurisdictions, to discuss EU listing issues and to share information and best practices. The Commission will also draw on the dialogue with third countries to identify concerns, which it will relay to the Member States in an effort to find solutions. One example of such concerns is the alignment of the national tax lists with the EU listing process in order to increase certainty and consistency.

   iv) *Strengthening tax good governance in agreements with third countries and expanding the dialogue with third countries on environmental taxes*: The Commission will continue to insist on the inclusion of the tax good governance clause in all relevant future negotiations on international agreements. In the event that a third country refuses to accept the clause, such country could be scrutinized under the EU listing exercise. According to the Communication, the Commission in its dialogue with third countries will also put emphasis on the "polluter pays principle," enshrined in the Treaty on the Functioning of the European Union (TFEU), which calls for pricing the negative externalities of polluting or other damaging activities.

3. **Promotion of Tax Good Governance through EU funds and strengthening of defensive measures against non-cooperative jurisdictions, to ensure that the EU's listing process has a real impact and provides clarity and certainty for third countries**. This includes:

   i) *Promoting Tax Good Governance through EU funds*: In the Communication, the Commission urges Member States to reflect the EU requirements in their national funding policies and in the compliance rules of their promotional banks and development agencies in order to ensure that no funds from the EU or its Member States would be channeled through entities from listed jurisdictions or be involved in tax avoidance schemes. In this context, the Commission also issued on 14 July 2020 a recommendation on making State financial support to undertakings in the EU conditional on the absence of links to non-cooperative jurisdictions. The restrictions should also apply to companies that have been convicted of serious financial crimes, including, among others, financial fraud, corruption, non-payment of tax and social security obligations. According to the Communication, the Commission will also launch, most probably by the end of 2020, a discussion with Member States to consider how an alignment of EU and national funding policies can be achieved and in parallel, it will continue to engage in close dialogue with the international financial institutions and other implementing partners, to review how the new EU requirements have impacted their work and processes.

ii) *Strengthening defensive measures against non-cooperative jurisdictions*: Member States have agreed on a toolbox of defensive measures to apply against EU-listed countries as of 2021. The Commission will monitor the situation and conduct an evaluation of those measures. Depending on the outcomes of the evaluation in 2022, it will consider a legislative proposal for coordinated defensive measures.

4. **Additional support for developing country partners in enhancing Tax Good Governance.** This includes:

i) *Strengthening partnership and cooperation internationally*: According to the Communication, the EU cannot work in isolation on Tax Good Governance and its implementation in developing countries. Strong collaboration with the OECD, the United Nations, the International Monetary Fund and other international actors is essential, to coordinate effective assistance and support. The Commission will also continue to encourage and support Member States in providing technical expertise on tax matters to the EU's developing country partners, via existing EU tools such as twinning and the technical assistance and information exchange instrument (TAIEX).

ii) *Integrating developing countries into the global tax framework*: The Communication states that the Commission will continue to support the active participation of developing countries in the OECD's Inclusive Framework for Base Erosion and Profit Shifting (BEPS) and the Global Forum on Transparency and Information Exchange and will work to ensure more targeted assistance and enhanced policy dialogue to support their domestic revenue mobilization.

iii) *Widening the policy agenda*: The Commission will also aim to integrate wider tax priorities in the EU's relations with developing countries. This includes for example, green taxation, the taxation of the digital economy and possible international corporate tax reforms.

Implications

With the publication of this Communication, it is apparent that intensifying the work on harmful tax practices, both within the EU and through the work on the list of non-cooperative jurisdictions will be a core objective of the Commission's work over the coming years. The proposals for expansion of the scope of the Code seek to support the Commission's agenda to ensure a minimum level of taxation both inside and outside the EU. The potential expansion of the territorial scope of third country reviews, the potential expansion of the work to other taxes and to general tax regimes which contain certain qualities such as exemptions of foreign income and the renewed attention for substance and transparency in relation to tax regimes within the EU would require many governments to reassess their tax policies and practices.

The Commission has now called upon the Member States through the Council to give high political priority to the proposals and to contribute to their implementation. Given the potential impact on a large number of jurisdictions it is expected that the negotiations on the proposals, that already started last week, will be intense. If agreement is reached on a set of measures in this context, the EU will again execute a process whereby it aims to ensure that non-EU jurisdictions are held accountable for legislation and practices that are not compatible with the norms defined.

Whatever direction the negotiations may take, it is clear that the Code has already had an increased direct impact on taxpayers inside and outside Europe, as many regimes which were qualified as potentially harmful were abolished and many non-EU countries joined the global standards on transparency and BEPS to escape being put on the EU list. A growing number of defensive measures and other rules have also been linked to the EU listing process. For the future, the potential use of the Code in the context of imposing a minimum level taxation may affect businesses that currently benefit from tax incentives or operate in low-tax jurisdictions. All taxpayers are therefore recommended to closely monitor the developments and assess the potential impact of the proposed rules on their business.

Endnotes

1. See EY Global Tax Alert, *European Commission adopts package for fair and simple taxation*, dated 16 July 2020.
2. See EY Global Tax Alert, *Council of the European Union publishes list of uncooperative jurisdictions for tax purposes*, dated 6 December 2017.
3. https://www.consilium.europa.eu/media/31945/st15429en17.pdf.
4. See EY Global Tax Alert, *EU Code of Conduct Group issues update report, including new guidance*, dated 12 December 2019.
5. See EY Global Tax Alert, *European Commission adopts first counter-measures on listed non-cooperative tax jurisdictions*, dated 22 March 2018.

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