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PLATFORM FOR TAX GOOD GOVERNANCE

Discussion paper on counter-measures towards non-cooperative third country jurisdictions

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Contact:
Secretariat Platform, Telephone (32-2) 29.55.762
E-mail: taxud-platform@ec.europa.eu

INTRODUCTION

Common EU list and possible countermeasures

In its External Strategy for Effective Taxation, the Commission proposed a new EU listing process to identify and act against third countries that fail to comply with tax good governance standards. The common EU list should also be backed by countermeasures for listed countries that refuse to comply with tax good governance standards.

In May 2016, EU Finance Ministers endorsed the EU listing process at ECOFIN and called on the Commission and the Code of Conduct Group to begin work on developing the list by 2017.

The ECOFIN also asked the Code Group to consider possible countermeasures to accompany the list. To assist Member States in this reflection, the Commission has identified three possible categories of countermeasures which could be applied:

- **EU legislation**: Relevant EU legislation could include stricter provisions for third countries that feature on the EU list of non-cooperative jurisdictions. Recent examples of such measures can be seen in the proposals for public Country-by-Country Reporting requirements, whereby companies would have to provide more detailed reports on their activities in listed countries than they do for other third countries. Likewise, under the 4th Anti-Money Laundering Directive, there is a (separate) EU list of countries with Anti-Money Laundering deficiencies. This list will trigger enhanced due diligence by EU economic operators regarding operations involving countries in those lists. EU legislation could be reviewed to identify where similar requirements could apply to jurisdictions on the common EU tax list.

- **EU funding**: The Commission is currently revising the EU's Financial Regulation, in order to prevent EU funds from being routed through problematic tax jurisdictions. It will present a proposal on this matter to Member States later this year. In addition, the internal rulebooks of the EU International Financial Institutions should be reviewed, to ensure that they take full account of third countries' tax good governance standards when deciding where to invest EU funds. The common EU list could be used to identify such problematic tax jurisdictions.

- **Coordinated national measures**: Member States could agree on common countermeasures, that they would apply against EU listed jurisdictions in a coordinated way through national law. When discussing possible coordinated countermeasures, Member States could examine current national countermeasures and draw on the experience and best practice in this regard.

Considering possible countermeasures for EU listed jurisdictions

The purpose of this paper is to launch a discussion on possible coordinated countermeasures that Member States could apply to third countries on the EU list, once it is in place next year. The countermeasures currently used by Member States may serve as inspiration for the discussion, but Platform members are welcome to make alternative suggestions too. It is proposed to have a separate discussion at a later date on the other two possible areas for countermeasures i.e. EU legislation and EU funds.

OVERVIEW OF MEMBER STATES' NATIONAL COUNTERMEASURES

Following the publication of a consolidated version of Member States' national lists in June 2015 ("pan-EU list"), it became apparent that more clarity on Member States' divergent listing processes was needed for transparency purposes. To this end, in January 2016, the Commission distributed a questionnaire to all members of the Platform on the criteria used and countermeasures applied by each Member State in relation to non-cooperative tax jurisdictions. A detailed overview of the replies on Member States' countermeasures is annexed to this document.

Taking an overview of Member States' countermeasures, outlined in the questionnaire replies, it appears that the most frequent national countermeasures are:

(1) Non deductibility of costs (NDC)

Non deductibility of payments made to legal persons located in third countries cover different types of expenses. I.e. limitation in the deductibility of:

- Interest
- Royalties
- Service fees
- All type of costs.

(2) CFC rules

CFC rules result in taxing in the hands of a resident company the profits made by the Controlled Foreign Company (CFC) established in a third country.

(3) Withholding Tax measures (WHT)

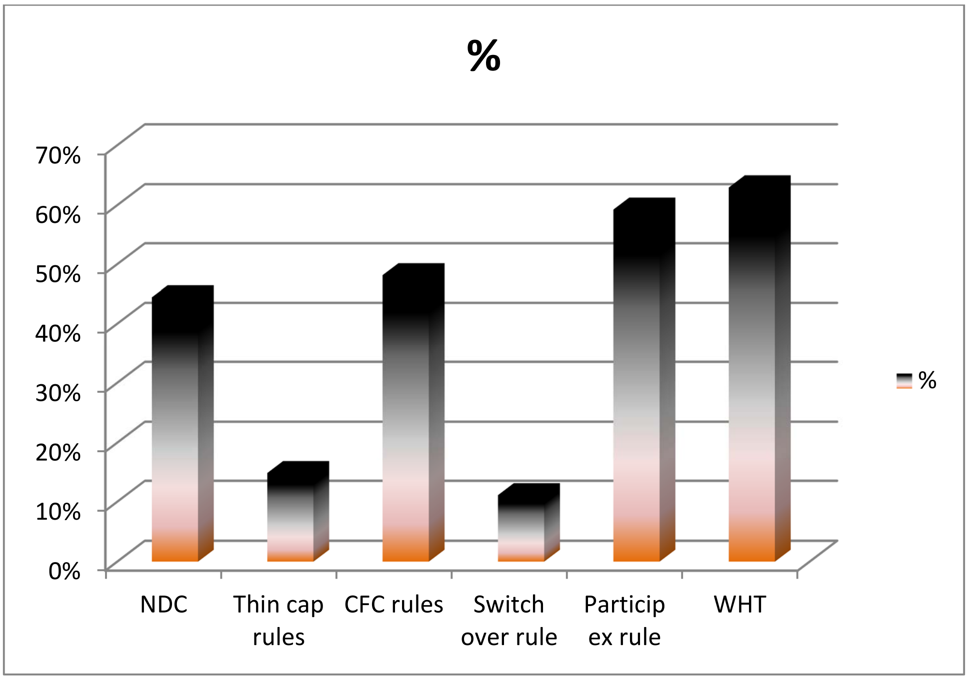
There are broadly 2 types of measures linked to withholding tax.

- Levying a WHT or a higher WHT on payments made to third countries;
- Disallowing reduced WHT rates.

(4) Participation exemption rule

The participation exemption rule may involve a refusal or limitation of the tax exemption if the foreign entity is located in a listed jurisdiction or if it does not meet certain criteria. These criteria may vary: deductibility of the payment in the third country, Parent-Sub Directive not applicable and absence of double tax convention, subsidiary subject to tax.

The graph on the next page shows how many countries use a specific national countermeasure in relation to all countries that replied the questionnaire. It also appears from the replies to the questionnaire that different types of countermeasures are generally applied to different type of jurisdictions depending on the kind of deficiency identified.



Questions for discussion

1. Do Platform members agree that coordinated national measures would be an effective way of applying countermeasures to jurisdictions that feature on the EU list?

2. Which type of countermeasures currently applied by Member States could be effective as possible coordinated measures? To which type of situation or deficiency should these measures apply?

3. What other possible countermeasures could be considered, beyond those currently applied by Member States?

ANNEX 1

SUMMARY OF REPLIES AND ANALYSIS

Below is a detailed overview of Member States' replies on the issue of countermeasures against non-cooperative tax jurisdictions, in response to the questionnaire sent by the Commission in January 2016.

(1) Non deductibility of costs (NDC)

Total of countries that apply NDC measures: 12 MS[1]

- Linked to a blacklist: 6 MS (BG/EL/FR/ LT/ LV/ SI)
- Not linked to a blacklist: 5 MS (AT/DE/EE/IE/SE)
- One MS (BE) uses 2 different NDC measures, one linked to a blacklist, and one not.

Rules denying or limiting the deductibility of costs cover different types of expenses and are triggered by different criteria.

A. Limitation of interest deductibility*: used by 12 MS in total.*

- Linked to a blacklist (BL)?
  - ➢ Yes: 7 MS
  - ➢ No: 5 MS

- Depending on what kind of deficiency?
  - ➢ Based on the subject to tax/minimum level criterion: 4 MS
  - ➢ Based on Transparency: 2 MS
  - ➢ Based on a combination of both Transparency and Tax Level: 4 MS
  - ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 2 MS

Note: the interest deductibility limitations discussed here are based on the characteristics of the jurisdiction in which the interests are paid and must be distinguished from the Interest limitation rule as contained in the ATAD Directive and proposed by the OECD BEPS project recommendations which are limitations based on the taxpayer's characteristics (EBITDA in this case). This last type of rules is treated under the "*Other measures"* section.

B. Limitation in the deductibility of royalties*: used by 8 MS in total.*

- Linked to a blacklist?
  - ➢ Yes: 5 MS
  - ➢ No: 3 MS

- Depending on what kind of deficiency?
  - ➢ Based on the subject to tax/minimum level criterion: 2 MS
  - ➢ Based on Transparency: 2 MS
  - ➢ Based on a combination of both Transparency and Tax Level: 2 MS
  - ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 2 MS

[1] Out of 27 replies received

C. The deductibility of service fees: *used by 7 MS in total.*

- Linked to a blacklist?
  - ➢ Yes: 5 MS
  - ➢ No: 2 MS

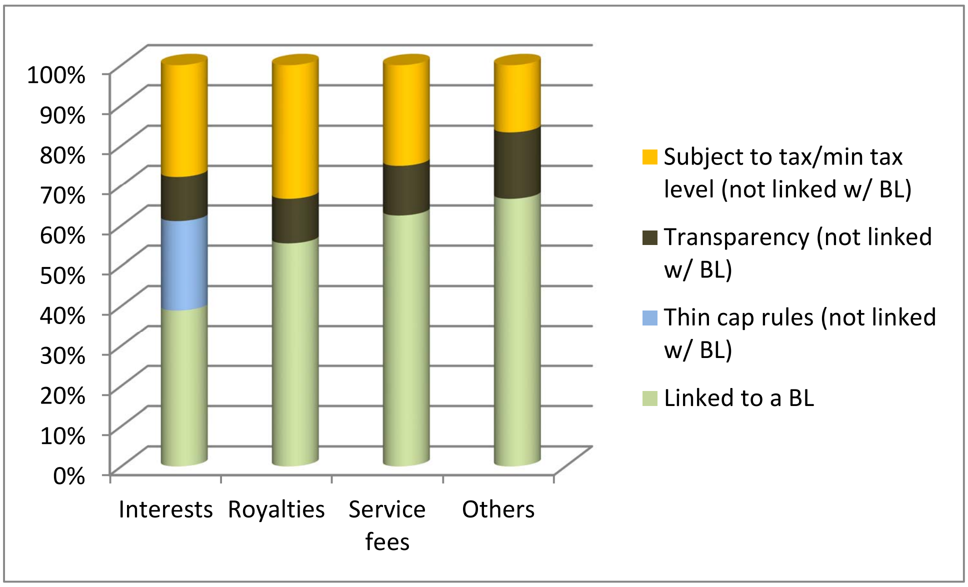
- Depending on what kind of deficiency?
  - ➢ Based on the subject to tax/minimum level criterion: 1 MS
  - ➢ Based on Transparency: 2 MS
  - ➢ Based on a combination of both Transparency and Tax Level: 2 MS
  - ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 2 MS

D. Deductibility of all type of costs *(including the purchase of goods): used by 6 MS in total.*

- Linked to a blacklist?
  - ➢ Yes: 4 MS
  - ➢ No: 2 MS

- Depending on what kind of deficiency?
  - ➢ Based on the subject to tax/minimum level criterion: 1 MS
  - ➢ Based on Transparency: 1 MS
  - ➢ Based on a combination of both Transparency and Tax Level: 2 MS
  - ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 2 MS

Deductibility of costs is usually accepted if the taxpayer can prove that these payments relate to real and ordinary transactions.



(2) CFC rules

Total of countries that apply CFC rules: 13 MS[2]

- Linked to a blacklist (or grey list): 5 MS (EL/ES/FI/FR/LT)
- Not linked to a blacklist: 8 MS (DE/DK/EE/HU/IT/NL/SE/UK)

On top of usual CFC criteria (such as the level of the controlling company's participation in the CFC, tests on assets of the CFC etc) the criteria on TEOI, HTM and Tax Level (either the tax level in the CFC's jurisdiction or the effective tax level of the CFC) are applied in 12 MS (out of 13 MS with CFC rules) as follows:

- ➢ Based on the subject to tax/minimum level criterion: 8 MS
- ➢ Based on Transparency: 1 MS
- ➢ Based on a combination of both Transparency and Tax Level: 2 MS
- ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 1 MS

The above information only reflects the current situation and will evolve over the next months or years as Member States will have to transpose the Anti-Tax Avoidance Directive (ATAD) before the end of 2018.

(3) Withholding Tax (WHT) measures

There are broadly 2 types of measures linked to withholding tax:

A. WHT (or higher WHT) on payments made to third countries

Total of countries that apply WHT measures: 13 MS[3]

- Linked to a blacklist: 7 MS (BG/ES/FR/HR/LV/PL/SI)
- Not linked to a blacklist: 6 MS (DK/EE /IT/RO/SK /SE)

Depending on what kind of deficiency?

- ➢ Based on the subject to tax/minimum level criterion: 2 MS
- ➢ Based on Transparency: 6 MS
- ➢ Based on a combination of both Transparency and Tax Level: 2 MS
- ➢ Based on a combination of both Transparency and absence of harmful tax measure (HTM): 1 MS
- ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 1 MS
- ➢ Other (Anti-abuse rule)[4]: 1 MS

B. Disallowance of reduced WHT rates

Total of countries that apply disallowance of reduced WHT rates: 6 MS[5]

- Linked to a blacklist: 3 MS (ES/PL/SI)
- Not linked to a blacklist: 3 MS (CZ/DE/LU)

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[2] Out of 27 replies received

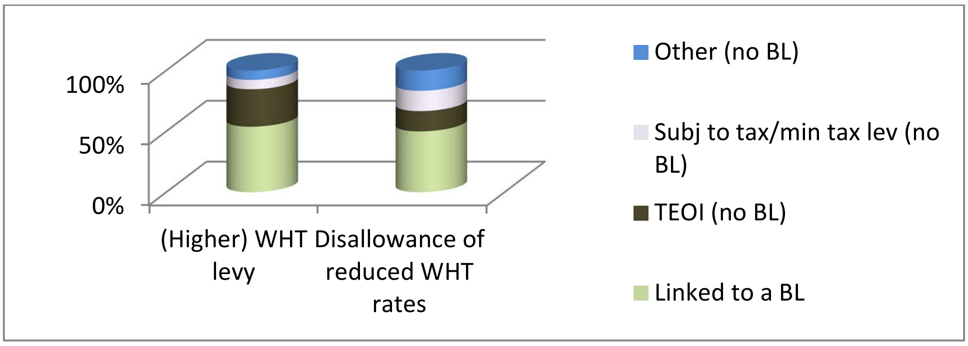
[3] Out of 27 replies received

[4] "Withholding tax can be levied on a dividend if the recipient of the dividend is not the beneficial owner, but holds the shares in its place, so that the beneficial owner can avoid taxes".

[5] Out of 27 replies received

Depending on what kind of deficiency?

- ➢ Based on the subject to tax/minimum level criterion: 2 MS
- ➢ Based on Transparency: 2 MS
- ➢ Based on a combination of both Transparency and Tax Level: 1 MS
- ➢ Other: 1 MS



(4) Participation exemption rule

Total of countries that apply the participation exemption rule: 16 MS[6]

- Linked to a blacklist: 8 MS (BE/BG/EL/ES/FR/LT/LV/SI)
- Not linked to a blacklist: 8 MS (AT/DE/DK/EE/LU/IT/MT/RO)

Depending on what kind of deficiency?

- ➢ Based on the subject to tax/minimum level criterion: 7 MS
- ➢ Based on Transparency: 2 MS
- ➢ Based on a combination of both Transparency and Tax Level: 3 MS
- ➢ Based on a combination of Transparency, absence of harmful tax measure (HTM) and Tax level: 2 MS
- ➢ Other: 2 MS(Deductibility of the payment in the third country (hybrid instruments

(5) Other measures

Some MS apply other types of measures, such as:

- Special documentation requirement for payments made towards blacklisted jurisdictions (FR, PL);
- Higher taxation of qualified capital gains (FR);
- Differentiated penalty framework (UK): penalty rates charged to individuals by HMRC vary according to the risk associated with specific countries. There are 4 categories, with category 0 receiving the lowest penalty, up to category 3 which receives the highest penalty. Categories are established depending on whether the jurisdiction exchanges information or not, and the way it exchanges information (automatically or on request); the category 0 contains all countries who adopt automatic exchange of information.

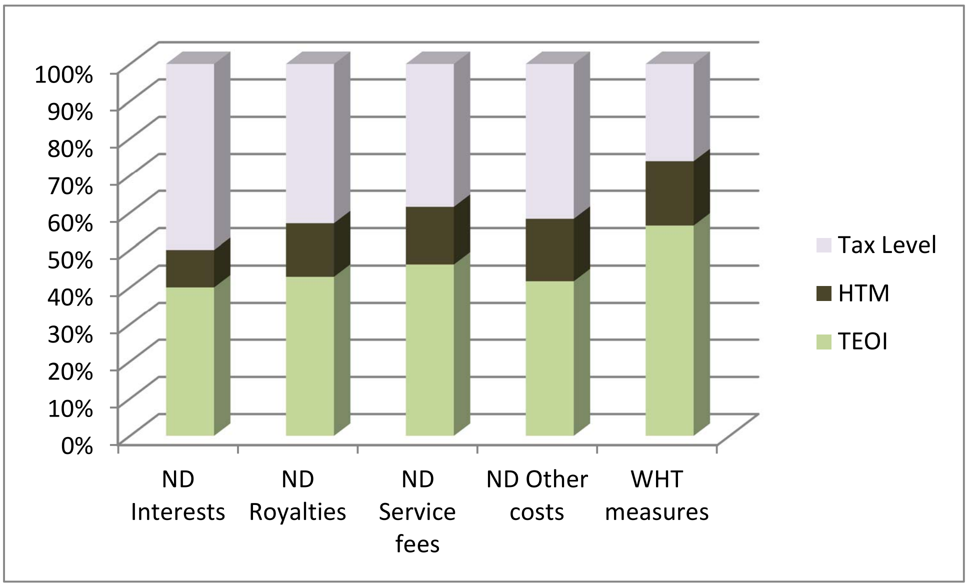
[6] Out of 27 replies received

- Thin capitalisation rules (BE, DE, DK, EL) based on the entity's EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization), EBIT or other ratios.
- Losses of an entity that forms part of a fiscal unit may not be taken into account for the assessment of its taxes (DE)
- Exit tax rule (DE)
- No double taxation treaties with jurisdictions that cannot meet the global standard on transparency and information exchange – especially jurisdictions unable to agree to include OECD Article 26 on exchange of information in the treaty (IE).
- A number of MS mention the application of a General Anti-Abuse Rule (GAAR) and/or various targeted anti-avoidance rules.
- Only 3 MS mentioned the use of a **switch over rule**.

Triggering factors

These measures are triggered by different criteria. The criteria used to trigger two of the most frequent types of measures targeting external threats, NDC and WHT, are summarised in the table and graphic below[7]:

		TEOI	HTM	Tax Level
Non deductibility of costs	ND Interests	8	2	10
	ND Royalties	6	2	6
	ND Service fees	6	2	5
	ND Other costs	5	2	5
WHT measures	WHT measures	13	4	6



This information is not systematically available for the other types of counter-measures.

[7] When a MS uses a measure triggered by two different criteria (TEOI and TL for instance), it is counted in both criteria