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Global Tax Alert

Council of the European Union publishes list of uncooperative jurisdictions for tax purposes

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The Council also issues conclusions on taxation of digitalized businesses, modernizing VAT for e-commerce

Executive summary

On 5 December 2017, the Council of the European Union[1] (the Council or ECOFIN) published a listing of "Uncooperative jurisdictions for tax purposes" (the listing), comprising 17 jurisdictions which were deemed to have failed to meet relevant criteria established by the European Commission (The Commission).

The Council also published their conclusions titled *Responding to the challenges of taxation of profits of the digital economy*, noting that it (the Council) "Looks forward to appropriate Commission proposals by early 2018" and "Takes the view that an appropriate nexus in the form of a virtual permanent establishment, together with any necessary corresponding amendments to the rules of transfer pricing and profit attribution, which would take into account where value is created in the different business models of the digital economy, should be explored."

Additionally, the Council agreed[2] on a series of new measures to support the digital economy in the area of value added tax (VAT) compliance.

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Detailed discussion

Listing of uncooperative jurisdictions for tax purposes

On 5 December 2017, the Council published a listing of non-cooperative jurisdictions in relation to taxation matters.

By way of background, work on this specific listing began in July 2016 with the Council's working group responsible for implementing a European Union (EU) Code of Conduct on Business Taxation (the Code of Conduct Group). In October 2017, letters were sent to all jurisdictions potentially affected, informing them of the outcome of the work. Where necessary, the jurisdictions were requested to make a political commitment to address all deficiencies within a specified timeframe. Most jurisdictions engaged with the EU and took steps towards resolving the issues identified and submitted the political commitment as requested, and progress made on those commitments will be monitored. Jurisdictions appearing on the list, the conclusions say, failed to take meaningful action to address identified deficiencies, and did not engage in a meaningful dialogue on the basis of the EU's criteria.

The conclusions, say the Council, seek to promote good governance worldwide to maximize efforts to prevent tax fraud and tax evasion. Seventeen jurisdictions[3] currently appear on the list. Following the Caribbean hurricanes earlier in 2017, the Code of Conduct Group put on hold its work in relation to eight jurisdictions,[4] but this will begin again in February 2018 and they will be asked to address any concerns identified as soon as the situation improves, with a view to resolving them by the end of 2018. The Council conclusions also refer to a total of 47 jurisdictions not included within the listing as they have made clear commitments in the areas of transparency, fair taxation and anti-base erosion and profit shifting (BEPS) measures. Many jurisdictions made commitments in more than one of these areas. Finally, the listing shall be revised by the Council at least once a year.

Listing criteria

The listing criteria are focused on three main categories: tax transparency, fair taxation and implementation of anti-BEPS measures. Further, specific information in regard to each criterion is set out in Annex V of the Council conclusions.

Defensive measures

The jurisdictions that appear on the listing are strongly encouraged by the Commission to make the changes requested of them. Pending such changes, Member States, say the conclusions, could consider applying one or more defensive measures, including both taxation measures and measures outside the field of taxation, aimed at preventing the erosion of their tax bases. The conclusions do not suggest EU Member States would be required to impose any of the suggested defensive measures, but many may choose to do so, especially those that already operate national-level blacklists. The suggested defensive measures in tax are as follows (found in Annex III to the conclusions, and set out verbatim):

B.1 To ensure coordinated action, Member States should apply at least one of the following administrative measures in tax area:

- Reinforced monitoring of certain transactions;
- Increased audit risks for taxpayers benefiting from the regimes at stake;
- Increased audit risks for taxpayers using structures or arrangements involving these jurisdictions.

B.2 Without prejudice to the respective spheres of competence of the Member States to apply additional measures, defensive measures of legislative nature in tax area that could be applied by the Member States are:

- Non-deductibility of costs
- Controlled Foreign Company (CFC) rules
- Withholding tax measures
- Limitation of participation exemption
- Switch-over rule
- Reversal of the burden of proof
- Special documentation requirements
- Mandatory disclosure by tax intermediaries of specific tax schemes with respect to cross-border arrangements

B.3 Member States could consider using the EU list of non-cooperative jurisdictions for tax purposes as a tool to facilitate the operation of relevant anti-abuse provisions, when implementing Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance

practices that directly affect the functioning of the internal market. For example, where, in accordance with that Directive, Member States, in transposing CFC rules into their national law, use "black" lists of third countries, such lists could cover at least the jurisdictions listed in the EU list of non-cooperative jurisdictions for tax purposes.

Such "Blacklists" are already in use in a number of jurisdictions globally, including Belgium, Brazil, Italy, Mexico and Spain, among others.

The conclusions also refer to counter-measures in the non-tax area, including the non-award of European Fund for Sustainable Development (EFSD) fund, EFSD Guarantee Funds of EFSD Guarantee. Alongside these specific measures, the conclusions also refer to the listing becoming a component of other similar blacklists that may be developed in the future by other parts of the EU organization.

Monitoring

The Council conclusions note that the EU's Code of Conduct Group should continue dialogue and monitoring the actual implementation of the commitments made by these jurisdictions and should recommend at any time to update the list of non-cooperative jurisdictions for tax purposes based on any new commitment taken and on the implementation of these commitments. Furthermore, the Council also asks the Code of Conduct group to prepare a progress report on this matter before summer 2018.

Delisting

The Council conclusions note that a jurisdiction may be de-listed from the listing by carrying out the specific steps that were communicated to the jurisdiction ahead of the listing's publication. However, as the conclusions note that the listing shall be revised by the Council at least once a year, it is possible that even after successfully carrying out those steps, a jurisdiction may find itself remaining on the list for some time thereafter.

Digital taxation

As part of its meeting, the ECOFIN Council also agreed on the EU's input to international discussions on the taxation of profits in the digital economy, calling not for immediate legislative proposals (as had been earlier called for on multiple occasions) but instead noting that it "Looks forward to appropriate Commission proposals by early 2018" and that it "Takes the view that an appropriate nexus in the form of a virtual permanent establishment, together with any necessary corresponding amendments to the rules of transfer pricing and profit attribution, which would take into account where value is created in the different business models of the digital economy, should be explored."

Moreover, the Council in its conclusions calls for an assessment of the legal and technical feasibility of the Commission proposals and an assessment of the economic impact of the possible responses. This is a new development, and potentially reflects the Council moving forward as much as it can to develop their proposals, including that of whether such proposals have a sound legal basis or would be in breach of either the EU's fundamental freedoms or the agreements of other multilateral bodies, such as the World Trade Organisation.

Earlier European discussions on digital taxation

The Council conclusions make mention of a potential short term solution to the issue, noting that "(Council) invites the Commission in responding to the challenges of taxation of profits of the digital economy to take into account paragraphs 13 to 20 of the present conclusions, and however, taking note of the interest of many Member States for temporary measures, such as for example an equalisation levy based on revenues from digital activities in the EU that would remain outside the scope of double tax conventions concluded by Member States, considers that these measures could also be assessed by the Commission."

The notion of such a levy came from a group of four countries (France, Germany, Italy and Spain) which suggested it to the Commission in September. The levy, the Commission says, could be designed to have a narrow base, such as fees from advertising only, or a more comprehensive scope, such as all digital services provided in the market country. It will be necessary to consider compatibility with other international agreements such as the World Trade Organisation agreements if it is to be applied to revenues earned by non-EU residents.

Longer term, the Presidency is pushing for a new nexus definition, which would work within the current corporate income tax system, but which introduces changes to ensure the rules work with the digital presence. In the view of the Presidency, this would ensure that international dispute resolution mechanisms commonly contained within tax treaties could continue to apply, unlike for an equalization levy.

Calls for global action, collaboration

The Council stressed the importance of global action and calls for the Organisation for Economic Co-operation and Development (OECD), EU and other international partners to work together to find appropriate solutions, which would include updating the global network of double tax treaties, modifying the OECD's Model Tax Convention and updating its transfer pricing and profit attribution guidelines to address global challenges.

The conclusions adopted are also intended to serve as a reference for further work on this area at the EU level, including the legislative proposals currently being explored by the Commission. While stressing the preference for a global solution, the Council has called for the Commission to present its proposals for legislative measures in early 2018, taking into account developments at the OECD and the legal, technical feasibility and economic impact assessments of the possible responses (which include temporary measures proposed by some EU Member States, such as Italy,[5] which has recently proposed a "Web Tax").

The Council has agreed that there is an urgent need to ensure that the existing international tax rules are suitable for both digital and more traditional sectors of the economy. While this goes beyond tax avoidance and evasion, there is a need, the Council says, to ensure a level playing field across the economy while ensuring that digital economy businesses pay their fair share of taxes. In keeping with views echoed by other countries, it confirmed its commitment to the existing tax policy that companies should be taxed where value is created, although there is a need to examine the importance of value creation and profit generation in the digital economy in order to ensure that the policy can be achieved. This examination is currently being undertaken by the OECD and is due to be covered in the interim report in April 2018.

The Council considers that the concept of a permanent establishment, together with the transfer pricing and profit allocation rules aligned to this, should remain one of the key principles for global profit allocation. However, the focus on a physical presence has been challenged by the increasing use of digital rather than physical presence, leading, the Council says, to distortions between where profits are taxable and where value is created. The Council considers that the absence of a physical presence should not prevent it from being subject to tax in that jurisdiction if significant activities are performed there, provided that an appropriate nexus is used, reflecting value creation.

The Council therefore considers that the following areas should be explored in further detail:

- Identification of an appropriate nexus, in the form of a virtual permanent establishment, together with any amendments to the transfer pricing and profit attribution rules to take into account where value is created in the different business model
- The relevance and feasibility of different elements of such a nexus (e.g., revenue-based, user-based and digital factors)
- The importance of various data (including user data) for value creation by digitalized companies in generating profits
- The barriers to and the possibilities created by the sharing of relevant information by digital platforms and marketplaces to the appropriate tax authorities, as well as the sharing of this among countries in accordance with international law

Modernizing VAT for e-commerce

During the meeting on 5 December, the Council also agreed[6] on a series of new measures to support the digital economy in regard to VAT compliance, which it says can currently place heavy burdens on small companies operating online. The new rules are aimed at accelerating growth for online businesses, in particular start-ups and small and medium enterprises. The measures include:

- New rules allowing companies that sell goods online to take care of all their VAT obligations in the EU through a digital online portal (One Stop Shop), hosted by their own tax administration and in their own language. These rules already exist for online sellers of electronic services (e-services).
- Establishing a new portal for distance sales from third countries with a value below €150.
- For the first time, large online marketplaces will be responsible for ensuring VAT is collected on sales on their platforms that are made by companies in non-EU countries to EU consumers. This includes sales of goods that are already being stored by non-EU companies in warehouses (so-called fulfilment centers) within the EU which can often be used to sell goods fraudulently VAT free to consumers in the EU.
- To support start-ups and micro-businesses, the introduction of a yearly VAT threshold of €10,000 under which cross-border sales to other countries within the EU are treated as domestic sales for online companies, with VAT paid to their own tax administration. This goes hand-in-hand with

other initiatives such as single invoicing rules, with the aim of making trading in the single market as similar as possible to domestic trading for these companies. Additionally, companies trading across borders with less than €100,000 cross-border sales will benefit from simplified rules.

- The removal of the current exemption from VAT for imports of small consignments worth not more than €22 from outside the EU, which leads to unfair competition and distortion for EU companies.

The European Commission says businesses currently operating outside of the Mini One Stop Shop (MOSS) have to pay an average of €8,000 a year to each Member State that they supply. An extension of the MOSS system could reduce regulatory costs for firms by €2.3 billion, while member states could see their VAT receipts rise by more than €7 billion annually.

The new rules will progressively come into force by 2021 and aim to ensure that VAT is paid in the Member State of the final consumer, leading to a fairer distribution of tax revenues among EU Member States. They will help to cement a new approach to VAT collection in the EU, already in place for sales of e-services, and fulfil a core commitment of the Digital Single Market (DSM) strategy for Europe. The agreement also marks another step towards a definitive solution for a single EU VAT area, as set out in the Commission's recent proposals for EU VAT reform.

Implications

Uncooperative jurisdictions for tax purposes

The publication of a listing of uncooperative jurisdictions for tax purposes had been widely expected for some time, and comes just a few months after the OECD announced that "massive progress" had been made over the past year, announcing that the blacklist of "uncooperative tax havens" it had prepared for the G20 leaders would have no entries.

The existence of a new listing of this nature will have significant impact around the world; as noted, some countries already maintain such "blacklists" at the national level, and the existence of a new listing by the EU may prompt such jurisdictions to refresh their listings or others to introduce new listings. Likewise, countries may adopt one or more of the counter-measures suggested by the Council conclusions.

Companies with any form of structure or transaction involving the named jurisdictions should therefore continue to monitor developments closely, as well as to assess alternative plans. In particular, affected businesses should pay close attention to any treaty obligations involving the listed jurisdictions.

The listing exercise will also have more widespread impacts; according to the commitments made by a number of jurisdictions, the Inclusive Framework on BEPS, for example, will grow by at least 12 members as a result of this exercise, while at least 6 jurisdictions have agreed to implement the automatic exchange of information by 2018.

Digital taxation

While the conclusions on digital may represent a slowing in the pace of developments in this area, they do not represent a significant change in direction. Indeed, the fact that the Council secured overall support on the proposed solutions is significant. Clause 25 of the conclusions in particular provides insight into potential future direction, noting that the Council "Looks forward to appropriate Commission proposals by early 2018, taking into account relevant developments in ongoing OECD work and following an assessment of the legal and technical feasibility as well as economic impact of the possible responses to the challenges of taxation of profits of the digital economy."

The reference to legal and technical feasibility as well as overall economic impact illustrate that the Council (and by logical extension, the Commission) want to do everything they can to continue to ready their proposals, allowing them to both influence the OECD's April 2018 report on the taxation of digitalized business for the G20 leaders and also to move quickly once the OECD report is published, should its findings not meet with their approval. Companies should therefore continue to closely monitor this evolving debate.

Endnotes

1. The Council is a body within which government ministers from each EU Member State meet to discuss, amend and adopt laws, and coordinate policies. The Council exists in ten different configurations, with the Economic and Financial Affairs Council configuration (ECOFIN) being the configuration that most commonly looks at taxation issues. The ministers have the authority to commit their governments to the actions agreed on in the meetings. Together with the European Parliament, the Council is the main decision-making body of the EU.
2. http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/.
3. American Samoa, Bahrain, Barbados, Grenada, Guam, Korea (Republic of), Macao SAR, Marshall Islands, Mongolia, Namibia, Palau, Panama, Saint Lucia, Samoa, Trinidad and Tobago, Tunisia and the United Arab Emirates.
4. Anguilla, Antigua and Barbuda, Bahamas, British Virgin Islands, Dominica, Saint Kitts and Nevis, Turks and Caicos Islands, and the US Virgin Islands.
5. See EY Global Tax Alert, *Italy considers Web Tax and other measures for digital economy*, dated 4 December 2017.
6. http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/.

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