TAX NEWS BULLETIN
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European Commission releases Action Plan: "Clamping down on tax evasion and avoidance"

At the March 2012 European Council, Member States asked the European Commission ("the Commission") "to rapidly develop concrete ways to improve the fight against tax fraud and tax evasion, including in relation to third countries". On 6 December 2012, the Commission issued and Action Plan with specific ideas on how to better tackle tax havens and aggressive tax planning.

The Action Plan sets out a comprehensive set of proposed measures, for now and for the future, to help Member States protect their tax bases and recapture billions of Euros legitimately due. More concrete measures have been proposed in two Recommendations from the Commission to its Member States.

1. Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters

The Member States recognize the potential and actual damage – such as tax base erosion, fair competition, and distortion of the internal market, caused by jurisdictions not complying with minimum standards of good governance. Although Member States have responded to this situation in various manners, taxpayers may structure business arrangements via the Member State with the weakest response, and the overall protection is only as strong as the weakest response of any one Member State.

With a view to tackling this issue, the Commission recommends the adoption by Member States of a set of criteria to identify third countries not meeting minimum standards of good governance, and the adoption of certain of measures against third countries which are non-compliant with these standards.

A third country only complies with minimum standards of good governance in tax matters where:

1. it has adopted legal, regulatory and administrative measures intended to comply with the standards of transparency and exchange of information set out in the Annex, and effectively applies those measures;
2. it does not operate harmful tax measures in the area of business taxation.

Tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the third country in question are to be regarded as potentially harmful. Such a level of taxation may operate by virtue of the nominal tax rate, the tax base or any other relevant factor.

Measures against non-compliant third states include black listing, renegotiation of double taxation conventions, or even suspension or termination of such convention.

2. Recommendation on aggressive tax planning

According to the Commission, a key characteristic of aggressive tax planning is that it reduces tax liability through strictly legal arrangements which however contradict the intent of the law. Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability. Aggressive tax planning can take a multitude of forms. Its consequences include double deductions and double non-taxation. As a result of the cross border dimension of many tax planning structures, domestic provisions against aggressive tax planning are often not fully effective.

The Commission recommends the making an exemption under double tax convention dependent on the taxation in the other contracting state, proposing the following clause:

'Where this Convention provides that an item of income shall be taxable only in one of the contracting States or that it may be taxed in one of the contracting States, the other contracting State shall be precluded from taxing such item only if this item is subject to tax in the first contracting State'.

An item of income should be considered to be subject to tax where it is treated as taxable by the jurisdiction concerned and is not exempt from tax, nor benefits from a full tax credit or zero-rate taxation.

The Commission further recommends the adoption of a general anti-abuse rule (“GAAR”) in double tax conventions, proposing the following clause:

'An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance'.

According to the Commission, an arrangement or a series of arrangements is artificial where it lacks commercial substance. In determining whether the arrangement or series of arrangements is artificial, national authorities are invited to consider whether they involve one or more of the following situations:

(a) the legal characterization of the individual steps which an arrangement consists of is inconsistent with the legal substance of the arrangement as a whole;
(b) the arrangement or series of arrangements is carried out in a manner which would not ordinarily be employed in what is expected to be a reasonable business conduct;
(c) the arrangement or series of arrangements includes elements which have the effect of offsetting or cancelling each other;
(d) transactions concluded are circular in nature;
(e) the arrangement or series of arrangements results in a significant tax benefit but this is not reflected in the business risks undertaken by the taxpayer or its cash flows;
(f) the expected pre-tax profit is insignificant in comparison to the amount of the expected tax benefit.

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