



Brussels, 6.12.2012
SWD(2012) 404 final

COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying

**the Communication from the Commission to the European Parliament and the Council -
An Action Plan to strengthen the fight against tax fraud and tax evasion**

**the Commission Recommendation regarding measures intended to encourage third
countries to apply minimum standards of good governance in tax matters**

the Commission Recommendation on aggressive tax planning

{ COM(2012) 722 final }
{ SWD(2012) 403 final }

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1. INTRODUCTION

The common purpose of national tax systems of EU Member States (MS) is to be effective and fair, i.e. to raise sufficient revenues in a fair manner in accordance with the democratic choices of each State. However, these objectives are threatened by a combination of tax fraud, evasion and aggressive tax planning often involving tax havens.

The amount of lost tax is difficult to estimate, but according to a study concerning the USA the revenue cost of profit shifting towards "tax havens" by US multinationals could be up to \$60 billion, while individual tax evasion could cost up to \$50 billion yearly¹. Estimates are not available for the EU, but on the basis of the similar amount of FDI stocks in "tax havens" in both USA and the EU the tax revenue losses can be estimated to be of similar magnitude.

The Impact Assessment analyses in a manner commensurate with each of the problems at stake the actions that could be considered to address those problems. The intention is to assist the Commission in selecting and deciding on the best policy options.

Terms used in this document can be found in a comprehensive glossary in annex 14 to the impact assessment report (see COM(2012)351² unless otherwise stated)

Tax fraud is a form of deliberate evasion of tax which is generally punishable under criminal law.

Tax evasion generally comprises illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities.

Tax havens, also sometimes referred to as '**non-cooperative jurisdictions**' (NCJ) are commonly understood to be jurisdictions which are able to finance their public services with no or nominal income taxes and offer themselves as places to be used by non-residents to escape taxation in their country of residence. **Tax avoidance** is a term difficult to define but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal is usually in contradiction with the intent of the law it purports to follow. (OECD Glossary Tax Terms)

2. PROCEDURAL ISSUES AND CONSULTATIONS OF INTERESTED PARTIES

The Impact Assessment was reviewed by the Impact Assessment Board. An extensive programme of consultation and research was carried out during 2012. This included a formal public consultation on Double Non-Taxation and an extensive data collection and analysis exercise by PWC on defensive tax measures in a sample of

¹ J; G. Gravelle (2009): Tax Havens: Tax Avoidance and Evasion. CSR Report for congress.

² COM(2012) 351 final

MS in relation to tax havens and aggressive tax planning. Only limited quantified data was available. For example the quantified benefits of some specific measures in Denmark, France Germany and the Netherlands ranged from 13 million euro to 1,500 million euro per year. In summary some MS are able to raise tax revenues by taking specific protective measures, although the precise types of measures differ.

Fiscalis Seminars on the issues were held with MS administrations and business, Non Governmental Organisations (NGO) and academic stakeholders. The main conclusions were general support for a) measures to enhance existing instruments of cooperation and the development of automatic exchange of information, and b) an EU coordinated approach including clear definitions of key concepts although some MS would prefer national measures and some attendees stressed the importance of not increasing administrative burdens nor effecting competition. No further quantitative data was received.

The Taxation Policy Group and **Council High-Level Working Party** have also discussed recently evasion and fraud and there is general agreement that enhancing action against this is a key priority. Measures must be proportionate and not lead to increased cost for taxpayers.

3. POLICY CONTEXT, PROBLEM DEFINITION, AND SUBSIDIARITY

Tax evasion and avoidance have developed internationally with the globalisation of the economy. The current economic crisis and budgetary constraints require that any losses of tax revenue are prevented, that tax systems are as efficient as possible, and to close opportunities for abuses, so as to secure sustainable tax revenues and support high levels of compliance based on fair and fairly applied tax systems.

3.1. Problem definition

Tax fraud and evasion limit the capacity of Member States to carry out their policies, and raise issues of fairness between compliant and non-compliant taxpayers.

Three problems need to be addressed within the EU:

- Insufficient tax collection within Member States, linked to low tax compliance and poor administrative capacity;
- Lack of effectiveness in cross-border administrative cooperation, which is limited by difficulties in identifying taxpayers in automatic exchange of information, and in agreeing in Council on closing loopholes from the Savings directive;
- Quality of tax legislation and its fitness for purpose because of insufficient use of existing legal instruments.

In an international context, the effectiveness of Member States' tax systems are undermined in three ways:

- because of their own unintended loopholes, and of mismatches occurring with other countries' tax systems leading to double non-taxation in cross-border situations. In

the EU Internal Market, double non-taxation gives a competitive advantage to some taxpayers, and may be detrimental for those Member States which see their tax bases eroded. It can be addressed by changes in national legislation and double tax conventions;

- because of taxpayers exploiting these loopholes and mismatches (aggressive tax planning). Tax planning increasingly involves ever-more sophisticated structures which develop across various jurisdictions and effectively, shift taxable profits towards states with beneficial tax regimes. The cross-border dimension of many structures and the increased mobility of capital and persons in the Internal Market makes it difficult for MS to address this alone;

- by other jurisdictions actively or passively facilitating the erosion of other countries's tax bases. This scenario can involve aggressive tax planning schemes, specific tax regimes providing a low level of taxation to non-residents, or a very low general level of taxation together with a reluctance to cooperate with other countries' tax administrations. Tax havens offer the possibility for taxpayers of other countries to relocate their tax bases in their low-tax jurisdictions, and to conceal this from their country of residence (through means such as obstacles to the identification of beneficial ownership and bank secrecy).

Although the precise dimensions of the revenue losses incurred are unknown they are generally accepted to be in the billions of Euro. Individual countries do sometimes estimate losses in revenue and academics have used a range of different methods to quantify them. These sometimes mix evasion and avoidance, combine direct and indirect taxes, include non-EU country data and use proxies such as the size of the 'shadow economy' to estimate tax losses. In addition some of the terms – evasion, avoidance and tax-havens for example are used in different ways. However, one example illustrates that there is a problem that needs resolving as quickly as possible. The UK alone recently estimated tax avoidance reduced revenues by several billion pounds³ annually.

The international dimension of this phenomenon makes it difficult for MS to protect their tax systems, since national anti-abuse measures can easily be circumvented by using complex tax structures and tax havens, or routing through another MS with a lower level of protection.

Despite several efforts at national level to try to influence third countries to apply minimum standards of good governance in tax matters (i.e. transparency, exchange of information and fair tax competition), a number of third countries remain reluctant to cooperate. Current leverage is therefore of limited efficiency.

3.2. Who is affected

EU MS are affected because of the budgetary impact and the need to adopt corrective measures (of administrative, regulatory or external policy nature).

Taxpayers are affected since the policies in the area concerned are important for guaranteeing fairness between them. They are also affected by corrective measures

³ Lifting the Lid on Tax Avoidance Schemes – July 2012 – <http://www.hmrc.gov.uk/>

from Member States. For example the latest guidance notes for applying a single piece of UK anti-avoidance legislation run to 115 pages. If all MS followed, a group of companies could be faced with considerable additional complexity. Moreover, the PWC study of fourteen MS found 165 different anti-abuse measures.

However there is no indication that Small and Medium Sized Enterprises (SME) would be more seriously affected than large enterprises, since activity with a cross-border dimension is more likely to involve the latter category. Citizens, as welfare-state beneficiaries, are indirectly affected by the shrinking budget for public services and social benefits.

Third countries are also affected, either as tax havens unduly attracting MS revenues, or as partner countries which flows may be affected by MS' anti-abuse rules. Where measures are targeted at specific countries (black or grey lists) there is little or no overall consistency amongst the EU MS.

3.3. Likely evolution of the problem (baseline scenario)

If no action is taken then MS will continue to have problems raising revenue and may have to raise taxes to secure their revenues.

In relation to fraud and evasion the three specific problems where action has been identified as decisive and urgent will remain.

No progress will materialise either in regard to third countries not complying with minimum standards of good governance in tax matters, in particular tax havens, as well as in regard to aggressive tax planning. It is likely that EU MS will react individually, within the limited effectiveness of such measures. In addition, there is little indication currently that MS would launch spontaneously initiatives at bilateral or multilateral levels to overcome jointly the problems. Other international initiatives (OECD) are unlikely to address the specific EU concerns.

3.4. Subsidiarity

MS encounter difficulties in protecting alone their tax systems efficiently because scattered national countermeasures are of limited effectiveness when it comes to cover the complexity of tax international avoidance schemes. Moreover, Member States could be lead to invidually reinforce such measures in a manner that would undermine regular business investment and create additional tax obstacles.

Thus, these national actions (or lack of action) have a direct impact on the functioning of the internal market as it can distort competition among EU businesses, and on the ability of Member States to meet the commitments of the Stability and Growth Pact⁴.

Therefore, action at Union level is better fitted to achieve the objectives.

⁴ http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm

4. OBJECTIVES

The general objective is to come, through a Union approach commensurate with the need to ensure the functioning of the internal market, to a better protection of MS tax systems against abuses and loopholes and, in particular, against cross-border international tax fraud and avoidance. Such practices are detrimental to MS tax revenues.

This general objective translates into the following specific objectives:

- In regard to cross-border fraud and evasion in direct and indirect taxation:
 - (Objective 1) Enhance tax co-operation, tax administration, tax enforcement and tax collection for cross-border operations between MS tax authorities
- In regard to jurisdictions not complying with minimum standards of good governance, in particular tax havens, and to aggressive tax planning:
 - (Objective 2) Closing loopholes and potential for abuse of MS direct tax systems (national legislation and DTCs) – this would contribute to addressing the issues of double non-taxation and aggressive tax planning
 - (Objective 3) Improving the efficiency of measures taken at national level to counter international tax avoidance – this would contribute to addressing the issue of aggressive tax planning
 - (Objective 4) Improving in an EU context the leverage that MS have towards third countries in tax matters – this would address the issue of jurisdictions not complying with minimum standards of good governance.

The operational objective is to secure and increase revenues for MS. Given the differences of MS tax systems and economic structures, the monitoring of this objective will need to be considered with each MS individually.

These objectives are consistent with other policies. They build on the existing policy of good governance in the tax area, and on the request from the European Council in March 2012 to enhance the fight against tax fraud and evasion. In a wider context they are consistent with efforts made against money-laundering and terrorist financing both at the EU level and by the financial action task force (FATF), and with the Annual Growth Survey 2012 and its recommendations to Member States to broaden tax bases and improve tax collection.

5. POLICY OPTIONS

The following table summarises the policy options identified to achieve the objectives.

Baseline scenario	
No EU change	
(Objective 1) Enhance tax co-operation, tax administration, tax enforcement and tax collection for cross-border operations between MS tax authorities	
- Option A1: Presenting an action plan including prioritising specific measures	
(Objective 2) To close loopholes and potential for abuse of MS direct tax systems (national legislation and double tax conventions)	
- Option B1: Address loopholes in national legislation through discussions in the Code of conduct Group for business taxation. As the Code is of Conduct group is discussing these issues this option is considered to be in place already	
- Option B2: Recommendation to prevent double non-taxation in double tax conventions.	
(Objective 3) To improve the efficiency of measures taken at national level to counter international tax avoidance	
- Option C1: Recommendation of EU compliant and effective general anti abuse rule (GAAR) as a standard	
(Objective 4) To improve in an EU context the leverage that MS might have in convincing third countries to implement good governance in tax matters	
- Option D1: Elaborate an EU definition of third countries not complying with minimum standards of good governance in tax matters, on the basis of principles recognised in this area	
- Option D2: Toolbox of measures to be applied according to whether or not the third countries concerned comply with the minimum standards defined.	

6. ANALYSIS OF IMPACTS OF THE POLICY OPTIONS

The following table summarises the analysis of the impacts (ascending scale from --- to +++).

Expected impact						
	Baseline scenario	A1	B2	C1	D1	D2
	Likely to continue or deteriorate					
Effectiveness in achieving policy objective	---	++	+++	++	+++	+++
Fundamental rights/ Four freedoms	--	-	+	+ / +++	+	=
Economic impact	---	++	++	+++	+++	+++
Social impact	--	+++	=	=	++	++
Impact on taxpayers/tax administrations	---	++ / +++	++	+++	++	+++
Impact on EU budget	=	--	=	=	=	=
Impact on other parties	=	=	=	=	-	-

7. COMPARISON OF MAIN OPTIONS

The following table summarises the comparative assessment of the options (ascending scale from --- to +++).

Comparison of policy options							
	Baseline scenario (no EU action)	A1	B1 Not assessed	B2	C1	D1	D2
Incentive for MS to strengthen their rules	=	+++		n/a	n/a	n/a	n/a
Effectiveness	---	+++		+++	+++	++	+++
Proportionality	=	+++		+++	+++	+++	+++
Efficiency	=	+++		+++	+++	+++	++
Flexibility	=	+++		+++	+++	+++	+++
Conclusion		Preferred option		Preferred option	Preferred option	Preferred option	Preferred option

8. THE PREFERRED OPTIONS

In view of its effectiveness proportionality and flexibility, the preferred option for meeting objective 1, i.e. enhance tax co-operation, tax administration, tax enforcement and tax collection for cross-border operations between Member States tax authorities, is the issuance of a prioritised action plan of measures. Choosing the no-change option would carry high risks.

The preferred options for dealing with third countries not complying with minimum standards of good governance in tax matters, as well as with aggressive tax planning, flow from the tables above, as a combination of Policy Options B2, C1, D1, and D2. This is a more detailed series of measures where rapid progress in the short term could be achieved.

9. MONITORING AND EVALUATION

In the absence of a reliable quantitative baseline for monitoring and evaluating progress regular reports should be prepared by the Commission on the implementation of the Action Plan and the above recommended actions.