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COMMUNITY ACTION TO COMBAT INTERNATIONAL TAX EVASION AND AVOIDANCE

(Communication from the Commission to the Council and to the European Parliament)

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I. INTRODUCTION

1. International tax evasion and avoidance unquestionably have implications for the Community and increasingly demand a Community approach, as economic and financial integration advances. It is obvious that when taxpayers escape their tax obligations distortions in the conditions of competition and capital movements can arise at the Community level.

   These problems are particularly pressing at the moment. All Member States face budgetary difficulties. Against this background, tax avoidance and evasion not only have direct repercussions - although the revenue effects are difficult to guage - but also carry a considerable psychological impact in terms of the fairness of taxation : if the general public has to be called upon to make what are often painful financial sacrifices, it is unacceptable that a limited number of taxpayers should manage to avoid contributing to the common effort.

   Moreover, the close link between honesty on the part of the taxpayers and their level of taxation cannot be denied. Taxpayers, indeed, have much less recourse to evasion and avoidance when they consider their level of taxation to be fair and reasonable, this can however only be so if tax obligations are fully respected by the taxpayers as a whole.

2. From another viewpoint the need to avoid the imposition on undertakings of new constraints which might seriously affect their competitiveness must not be overlooked.

   Care must therefore be taken that the effects, on the competitiveness of undertakings, of steps which might be taken in the fight against evasion and avoidance are not out of proposition with the desired objective.

3. In addition, the effect of tax harmonization in this context must be stressed: all convergence in the rules governing taxation tends to reduce at the same time, the incentive to evasion and avoidance and the possibility of such practices, within the Community.

4. The community has been studying the problems of tax evasion and avoidance for some years.

In 1973 the Commission sent the Council a report on the tax arrangements applying to holding companies (1) that examined inter alia the use of this type of company for the purpose of avoiding tax and suggested how this problem could best be remedied.

On 10 February 1975 the Council, acting on a proposal from the Commission, approved a resolution (2) which, given the international dimensions of tax avoidance and evasion, stressed the need for closer collaboration between national tax administrations.

On 19 December 1977, following up its resolution, the Council adopted, on a Commission proposal, a Directive concerning mutual assistance by the Member States in the field of direct taxation (3).

Such assistance consists essentially in the exchange of information, either on request or on the initiative of the Member State possessing the information.

The assistance arrangements were subsequently extended to embrace VAT by the Directive of 6 December 1979 (4). Another Directive of the same date introduced arrangements for mutual assistance in the recovery of VAT claims (5).

5. The problems of international tax evasion and avoidance are also the subject of particularly close scrutiny by Parliament. In its resolution of 17 November 1983 on the harmonization of taxation in the Community (6) Parliament once again called upon the Commission to step up action in this field and to report on the state of implementation of the Directive of 19 December 1977.

This Communication is also addressed to Parliament in response to that request.

(1) Doc. COM(73)1008 final of 18 June 1973
(2) OJ No C 35 of 14 February 1975, p. 1
(3) OJ No L 336 of 27 December 1977, p. 15
(4) OJ No L 331 of 27 December 1979, p. 8
(5) OJ No L 331 of 27 December 1979, p. 10.
(6) OJ No C 342 of 19 December 1983, p. 73

II. PRESENT SITUATION AND PROPOSALS FOR REINFORCING COMMUNITY ACTION

6. The action to be taken by the Community concerns :

a) The improvement, intensification and extension of collaboration :

- between tax administrations in the Community ;
- between the latter and their counterparts in third countries ;

b) the problem of the use of tax shelters ;

c) the problem of the transfer of profits between companies belonging to the same group ;

d) the elimination of double taxation.

Collaboration between Member States' tax administrations

7. As indicated at point 4 above, the Directive of 19 December 1977 introduced arrangements for mutual assistance within the community based essentially on the exchange of information.

A provision was included in that Directive to facilitate improvements to the assistance machinery. Article 10 states : "The Member states shall, together with the Commission, constantly monitor the cooperation procedure (...) and shall pool their experience, especially in the field of transfer pricing (...), with a view to improving such cooperation and, where appropriate, drawing up a body of rules in the fields concerned."

That the drive against tax evasion and avoidance is a stated policy objective in all Member states has not prevented some of them from failing to meet the deadline of 1 January 1979 for compliance with the Directive. Belgium did not adopt the act incorporating it into national law until 8 August 1980 and the relevant law in France is dated 31 December 1981. In Italy , it was not until 5 June 1982 that a decree laying down the necessary measures was enacted. The commission considers that Germany has not yet complied with the Directive and has accordingly instituted infringement proceedings under Article 169 of the Treaty. The case of Greece, which has also not yet incorporated the Directive into national law, is at present being examined by the Commission's departments.

8. Under these circumstances, it is not surprising that the pooling of experience provided for in Article 10 of the Directive has revealed that the opportunities afforded under the Community procedures are far from being fully utilized. The Member States still seem to be operating mutual assistance on a purely bilateral basis, as envisaged under traditional bilateral conventions, showing little awareness of the possibilities for a multinational exchange of information which it was the very purpose of the Community Directives to establish and develop.

Even more so than in the field of direct taxation, such a state of affairs is regrettable in the VAT sphere, in which there are no bilateral agreements and the Directive is the only instrument of international cooperation.

9. The problem is therefore how to make better use of the possibilities opened up by the Directives and improve mutual assistance. In this respect and while emphasizing that this implies, in the first place, a change of attitude towards new ideas which are no longer those of a time when relationships between states were solely bilateral, the Commission takes the view that, among the different measures that can be taken, efforts must be focussed on those examined below.

It is of course understood that it is better to avoid any increase in the obligations imposed on taxpayers in sofar as administrations can themselves obtain the necessary information.

Organizational measures at national level

10. If the international exchange of information is to function smoothly, each Member State must create the necessary conditions at national level.

Member States must first exhaust all the national sources of information relevant for determining taxes. This calls for close cooperation not only between the direct taxation and indirect taxation authorities where the two are separate but also between the tax administration and other administrations (e.g. social security departments in the case of medical fees or public works department in the case of government procurement).

11. Computerization of data handling is another important measure. If stored at a central office, information of interest for the purposes of international cooperation could be accessed immediately. Most Member States have already

set up such central offices, but too many of them are not equipped with the necessary technical resources.

Limits to the exchange of information

12. Article 8(2) of the Directive of 19 December 1977 stipulated that the provision of information may be refused where it would lead to the disclosure of a commercial, industrial or professional secret or of a commercial process or of information whose disclosure would be contrary to public policy.

When the Directive was adopted, a statement was entered in the Council minutes to the effect that after five years, acting on a proposal from the commission, the council would consider whether it was necessary to maintain this provision.

The Commission is currently seeking from Member States the information necessary for a re-examination of this provision limiting the exchange of information.

Simultaneous checks

13. Where the campaign against tax avoidance and evasion is concerned, the most important sector from both an economic and a tax angle is most probably the corporate sector, and in particular associated enterprises. The only effective way to counter the tax evasion and transfers of profits which are facilitated by close cooperation between enterprises is to step up collaboration between tax administrations. The Directive of 19 December 1977 already provides for the spontaneous exchange of information in such situations (see Article 4(1)(d)), but more direct cooperation measures are becoming increasingly necessary in this field. Some sporadic measures have already been taken but they now need to be more systematically organized at Community level.

Some administrations, each acting within the limits of its territorial competence, have carried out simultaneous checks on associated enterprises in different countries with the intention of exchanging the information obtained. Simultaneous checks of this kind need to be conducted more often and coordinated at Commuunity level. The more administrations taking part, the more effective they would be.

One obstacle to cooperation of this sort is the fact that checks on enterprises are not sanctioned by law or practice in some countries. The first step in those countries must be to provide for possibility of such checks.

It should not in any case be forgotten that simultaneous tax checks could also be in the interests of the enterprises themselves since in some instances discussions between administrations may well avert double taxation at the very outset.

14. It would also be a welcome step if Member states made greater use of the possibilities afforded by Article 6 of the Directive, under which officials from another Member State may be present when tax checks are carried out by a national tax administration.

Payments abroad

15. Where checks not only on enterprises but also on other taxpayers are concerned, one efficient technique that could be widely applied does not appear to be used sufficiently.

Payments abroad usually have two features in common : first, the identity of the foreign recipient is known to the payer, and second, payments made are deductible from taxable income. This situationcould be turned to account for tax control purposes by making the deduction conditional on the payer informing his tax administration of the recipient's identity. The tax administration could centralize such information and process it using computers (see point 11).

Such a technique could be used more systematically than at present and with virtually unlimited coverage. It would permit automatic, or at least spontaneous, notification in the case of important classes of income such as royalties, commission payments, rebates, loan interest, attendance fees, etc. It would also be a useful tool in the crackdown on certain practices such as the "black" economy and the hiring out of labour across frontiers, which are particularly widespread at a time of serious economic difficulties.

16. At the same time, enterprises could be required to attach to their tax return details of transactions with associated enterprises abroad : their nature, sums paid or received, etc.

17. Information on holdings

In the interests of obtaining fuller information on tax situations, it would be very useful if taxpayers were required to provide certain information not only when income is realized but also at the time when the economic links that will subsequently generate income are established. For instance, a requirement that the tax administration be informed as a matter of course of the acquisition of a substantial holding in a foreign enterprise (or vice versa) would result in the centralizing of information on all relationships between enterprises. If each Member State gathered such information, a clear picture could be compiled of inter-company links, including indirect holdings through a company established in a tax shelter. Such a system would obviously permit better monitoring of profit transfers from the outset.

18. This communication has so far considered measures to improve mutual assistance for the correct determination of taxes. Steps should also be taken to prevent taxpayers from evading their tax liabilities. This is why the Commission takes the view that arrangements similar to those already in force in the VAT field should be introduced for the enforced recovery of claims in respects of taxes on income and wealth tax. In due course, it will present a proposal for this purpose.

Collaboration between the Community and non-member countries

19. Moves to establish or improve cooperation with non-Community countries in the matter of administrative assistance face daunting problems. In its resolution of 10 February 1975 on the measures to be taken by the Community in order to combat international tax evasion and avoidance (1), the Council recognized the international dimension of the problem and stated that collaboration with third countries should be strengthened.

(1) OJ No C 35 of 14 February 1975, p. 1.

Three moves are now in progress at Community level or in other international organizations.

20. In 1979 Finland, Iceland, Norway and Sweden approched the Commission with a request to open negotiations with a view to their participation in the exchange of information provided for in the Community Directives. In a recommendation for a Council Decision of 20 February 1980 (1), the Commission asked the Council for authorization to conduct those negotiations.

The Council has not yet responded as most Member States argue that the assistance clauses included in their bilateral conventions with non-Community countries are sufficient. If this were a valid argument, it would necessarily hold for relations between Member States too.

Then again, their stand has not prevented the Member States from taking part in the negotiations on a multilateral Council of Europe Convention on administrative assistance in tax matters (see point 21). Under the circumstances, there is little or no justification for the lack of a positive response to the request from the aforementioned countries.

Accordingly, the Comission urges the Council to take a decision at the earliest opportunity.

21. The Council of Europe has taken the initiative of drawing up a multilateral Convention on administrative assistance in tax matters for signature by its Member States and by the Member States of the OECD.

The Commission welcomes this initiative provided it results in an effective improvement in cooperation with non-Community countries. It has always maintained that the wider the geographical scope, the more effective the drive against international tax evasion and avoidance will be.

The draft Convention, which is currently being discussed by a committee of experts, covers a wider range of matters than the community arrangements.The assistance provided for covers the entire range of taxes and social security contributions. What is more, it extends not only to the exchange of information but also to the recovery of tax claims and the service of documents.

(1) Doc. COM(80)68 final of 20 February 1980.

The Convention concerns the community in two ways. In areas not yet as covered by common rules, Member States'positions ought to be coordinated (Article 116 of the Treaty). With this in mind, the Commission departments have sent the Council two working papers that have been discussed at expert level.

In areas already covered by Community instruments, it is for the Community to participate in the multilateral Convention . To this end, the Commission recently transmitted a recommendation for a Decision to the Council(1). Since the negotiations have reached an advanced stage, it is essential that the Council take its decision as soon as possible.

22. The UN is also taking an interest in combating international tax evasion and avoidance by means of cooperation between national administrations. A special UN group of experts recently completed the drafting of directives that are to be addressed to the tax authorities. These directives concern cooperation in the exchange of information, the use of tax havens, banking secrecy, the abuse of conventions and the collection of taxes.

The UN has on numerous occasions witnessed a clash of interests between the industrialized countries and the developing countries, the more so as many developing countries are already tax havens or are moving in that direction.

Tax shelters

23. The use of letter-box companies established in tax havens (i.e. companies which do not engage in any genuine economic activity but merely collect and hold certain "passive items of income" such as dividends, interest and royalties) was discussed in the 1973 report on holding companies.

In that report, the Commission stressed that the problem of letter-box companies established within the Community could not be isolated from the problem of letter-box companies in general and that only concerted action extending beyond the community framework could provide a balanced solution. Until such time as action could be undertaken along those lines, more limited measures were all that could be envisaged.

(1) Doc. COM(83)685 of 22 November 1983

At the time, the Commission looked at a number of such measures already operative in some Member States under which certain tax effects were applied to payments made to a tax haven from a Member State (e.g. charging a withholding tax on royalties, shifting the burden of proof). A more thorough examination revealed that the generalized application of such measures on the basis of common rules would hardly be feasible.

24. In recent years, a number of countries have introduced (France, Japan, Canada and recently the United Kingdom), another unilateral but much more general measure that has been in force in the United States since 1962 and in Germany since 1971. In essence, the measure is to tax a resident taxpayer on the "passive items of income" accruing to his letter-box company established in a tax haven even if such income is not distributed, the amount of tax payable being in proportion to the taxpayer's stake in the company.

Any legislation directed against tax havens (even on the limited scale discussed above) would involve problems of definition and demarcation. These problems, already highly complex at a theoretical level but even more so when it comes to their practical application, concern not only the definition of "tax haven" but above all the definition of taxable "passive items of income", it being understood that any obstacle to the genuine international activity of companies must be strictly avoided.

If the measures were implemented with varying success from one national administration to another, something that may even occur within a Member State, this might engender fresh distortions of competition, making matters worse, not better.

25. In the final analysis the Commission considers that for the time being Community measures to combat the use of tax havens must relate to supervision and mutual assistance, in particular within the framework of the spontaneous exchange of information provided for in Article 4 of the Directive of 19 December 1977. The aforementioned improvement in that machinery is one example.

Transfer of profits

26. One particularly important current form of international tax evasion is the transfer of profits between companies belonging to the same group but situated in different countries. By over-stating or under-stating in all manner of ways transactions carried out across frontiers but within the group, companies are able artificially to transfer profits from one country to another so as to minimize the tax burden on the group as a whole.

The Commission has always been alive to this problem (1). Article 10 of the 1977 Directive on mutual assistance (see point 4) provides for a pooling of experience in this field in particular, with a view to drawing up common rules where appropriate. The OECD, in its 1979 report, looked at the problems of the transfer of profits within multinationals and presented "guidelines" for resolving them. However, that report is in the nature of a recommendation only and leaves the OECD's Member States wide discretion.

Before any new initiatives are launched in this field, there is a case for waiting until Member States have gained sufficient experience in applying the OECD guidelines. There is no doubt though that the Community needs binding rules, not only in order to reinforce measures to combat the transfer of profits but also in order to ensure that companies can count on the same principles being applied throughout the Community. At the same time, this would reduce the risk of double taxation.

Nevertheless, because of the manifold complex problems to be resolved and the sometimes divergent traditional approaches, the conflicting interests of Member States and their reluctance to submit to rules in this area, we would be deluding ourselves if we expected substantial progress in the near future. In the meantime, we must prevent unilateral, uncoordinated measures by Member States opening up a widening divergence. National measures planned in this field be notified to the Commission and to the other Member States

(1) see "Action Programme for taxation", doc. COM(75) 391 final of 23 July 1975.

so that they can give their opinions. The procedure laid down in the proposal for a Decision sent to the Council by the Commission on 3 December 1981(1) would provide an appropriate framework.

Elimination of double taxation

27. The growing cooperation between national tax administrations increases the risk of double taxation, especially in the case of transactions between connected enterprises, which also produce distortions in the conditions of competitition. For this reason, the Commission has always emphasized the close link that exists between measures against tax avoidance and the prevention of double taxation (2).

As things stand, double taxation can be eliminated only be initiating the amicable procedure provided for in bilateral conventions. However, this procedure does not actually guarantee elimination of double taxation if the two administrations concerned are unable to come to an agreement.

To remedy this, the Commission sent to the Council in 1976 a proposal for a Directive(3) aimed at establishing a procedure that would guarantee the elimination of double taxation in all cases.

Following a communication from Mr. TUGENDHAT on fiscal measures aimed at the encouragement of cooperation between undertakings of different Member States (4) discussion on the proposal has made considerable headway within the Council. most of the problems have been settled and the last few matters of detail outstanding could be resolved shortly. However, one important problem remains, the choice of the legal instrument to be used. Most Member States are in favour of a multilateral convention based on Article 220 of the Treaty, whereas the Commission, in the belief that all the conditions laid down by Article 100 are met, considers that only the adoption of a directive would be in keeping with Community law.

(1) OJ No C 346 of 31 December 1981, p. 6.

(2) See "General considerations" in the proposal for a directive on the exchange of information, doc. COM(76)119 final of 31 March 1976

(3) OJ No C 301 of 21 December 1976, p. 4.

(4) Doc. SEC(84)77 of 17 January 1984.

III. CONCLUSIONS

28. The Commission considers that the time has come to impart fresh impetus to the drive against international tax evasion and avoidance.

29. That means first, strengthening mutual assistance within the Community. This can be achieved largely by making fuller use of the possibilities for collaboration afforded by the existing Directives, which, for the moment at least need be supplemented only as regards the enforced recovery of claims in respect of direct taxation.

30. Second, if practices which increasingly ramify not only beyond national frontiers but also beyond the frontiers of the Community are to be effectively combated, the Community's assistance arrangements must be extended to include other countries, and in particular the Community's major trading and financial partners. This is why the commission urges the Council to take an early decision on the request received from the Nordic countries, whose participation in the Community mutual assistance procedures would add considerably to their effectiveness. Similarly, the Council must expedite its response to the recommendation for a Decision authorizing the Commission to conduct the negotiations on the multilateral Council of Europe Convention.

31. As regards the introduction of measures to resolve the problems of substance, whether the use of tax shelters or transfer pricing, considerable caution is called for, if the Community's competititive position is not to be weakened or legitimate interests injured. It would also be wise to wait until unequivocal lessons can be drawn from the application of the OECD directives.

32. Lastly, the Commission would reinterate the view it has always held, namely that measures to combat tax evasion and avoidance and those to eliminate double taxation complement each other. Accordingly, the early establishment of an arbitration procedure would not only answer the need for fairness with regard to companies operating across frontiers but would also encourage those companies to act in a more responsible manner in tax matters.