European Commission

Combating tax fraud and evasion

Commission contribution to the European Council of 22 May 2013

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Ahead of the 22 May European Council, this paper recalls the importance of taxation in the current context of fiscal consolidation in Member States and in particular the negative impact of tax fraud and tax evasion.[1] *The fight against tax fraud and evasion is important both for the protection of national budget revenues and for the confidence of citizens in the fairness and effectiveness of tax systems.*

This paper focuses both on the reforms that Member States must undertake to address these challenges and what still needs to be agreed and implemented at EU level. A coordinated EU approach can strengthen our collective capacity to combat tax fraud and tax evasion and to promote high standards of tax governance globally.

1. The need for determined action to fight tax fraud and tax evasion: securing fiscal consolidation efforts and fairness of tax systems

Tax fraud and tax evasion are limiting the capacity of Member States to raise revenues and to carry out their economic policy. Estimates show that tens of billions of euros remain offshore, often unreported and untaxed, reducing national tax revenues. Decisive action to minimise tax fraud and tax evasion could generate billions in extra revenue for public budgets across Europe.

Tax fraud and tax evasion are also a challenge for fairness and equity. Fairness is an essential condition to make the necessary economic reforms socially and politically acceptable. The burden of taxation should be spread more evenly by ensuring that everyone, whether blue-collar employees, multi-national companies that benefit from the single market or wealthy individuals with offshore savings, contribute to public finances by paying their fair share. Fairness and equity also mean creating better and fairer taxation systems.

Combating tax fraud and tax evasion requires action at national, EU and global level. The European integration process has led to closer integration of the economies of all Member States, with high volumes of cross-border transactions and the rolling back of cross-border transaction costs and risks. This process has generated huge benefits for European citizens and businesses but it has, in turn, created additional challenges for national tax administrations in terms of co-operation and exchange of information. Experience has shown that Member States can only address these challenges effectively if they work together through a framework agreed at EU level. Unilateral solutions alone will not work. In a single market, within a globalised economy, national mismatches and loopholes are too easily exploited by those that seek to escape taxation.

[1] Tax fraud is a form of deliberate evasion of tax which is generally punishable under criminal law. The term includes situations in which deliberately false statements are submitted or fake documents are produced. Tax evasion generally comprises illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he or she is legally obliged to pay by hiding income or information from the tax authorities.

The EU has a long-standing and well-established policy on good governance in tax matters. The principles underpinning the EU system are transparency, automatic exchange of information and fair tax competition. The EU can draw on several years of experience: automatic exchange of information has been the EU standard since 2005 for savings income.

The EU has developed a comprehensive tool box to improve the ability of Member States to fight tax fraud and tax evasion. This comprises EU laws (on improved transparency, exchange of information and administrative cooperation), coordinated actions recommended to Member States (for example on aggressive tax planning and tax havens) and country specific recommendations on strengthening the fight against tax fraud as part of the European Semester of economic governance. In addition to this, the Commission presented a specific Action Plan last December setting out key actions that will help Member States with their fight against tax fraud and tax evasion in the field of direct and indirect taxation.

A number of important steps have already been taken and Member States should make better use of the available tools. The priority now is for Member States both to make necessary improvements to their national systems, as well as to make full use of the European toolbox and to implement what has been agreed in a thorough and coordinated way.

2. Action at national level

Member States can increase tax revenues through systematic action to reduce the shadow economy, to combat tax evasion and to ensure greater efficiency of tax administrations.

The on-going economic and financial crisis in the EU is having severe budgetary and social consequences in Member States. Public finances urgently need to be overhauled to sustain welfare systems and public services, to limit the costs of re-financing for the State and other public authorities, and to avoid negative spill-overs for the rest of the economy. By reducing tax fraud and evasion Member States can increase tax revenues which will also give them more leeway to restructure their tax systems in a way that better promotes growth. It can also support Member States' efforts to relieve the tax burden on low-income earners and on the most vulnerable groups.

Better tax administration is a particular challenge in a third of Member States due to a variety of factors. These include for example high administrative costs per net revenue collected, the failure to use third-party information to prefill tax returns, the limited use made of e-filling, and the heavy administrative burden of tax systems for medium-sized companies.

In the Annual Growth Survey for 2013, the Commission identified as a priority for this year the need to pursue differentiated, growth-friendly fiscal consolidation. Among other actions on the revenue side, the Commission recommended that Member States improve their tax compliance by combating tax fraud and tax evasion more effectively. As in 2012, this priority will be reflected in the Country Specific Recommendations for 2013.

Box 1: What has to be done at national level?

- **At national level, in the context of the European Semester, Member States should implement the country specific recommendations addressed to them** in order to face the challenge of improving tax governance. Measures to improve tax compliance and promote more efficient tax administrations include

– developing a compliance strategy and targeting efforts against tax evasion,

– the extension of the use of third-party information,

– the preparation of pre-filled tax returns, and

– concerted efforts to reduce the size of the shadow economy by for example criminalising the purchaser of undeclared work, the use of mandatory electronic payments for purchases over a threshold or the use of monetary incentives to declare (tax deductions).

- **Member States should fully implement the Commission's Recommendations on tax havens and aggressive tax planning**, which relate in particular to the identification of third countries that do not apply minimum standards of good governance in tax matters; the provision of technical assistance to third countries willing to comply; and measures to avoid double non-taxation.

- **The Commission is ready to provide targeted support and technical assistance to any Member State that needs it to strengthen its tax system against evasion, and improve tax collection**. In Greece, for example, the Task Force for Greece, together with experts from Member States, is actively engaged in helping build a more robust tax system to deliver quality revenues, and positive results are already beginning to emerge.

3. Action at EU level

The EU has developed a comprehensive toolbox to improve the ability of Member States to fight tax fraud and tax evasion. This comprises EU legislation (on improved transparency, exchange of information and administrative cooperation), coordinated actions recommended to Member States (for example on aggressive tax planning and tax havens) and country specific recommendations as part of the European Semester. The EU will also provide financial support for cooperation between national tax authorities through the **Fiscalis 2020** programme.

The EU system is built on the principle of automatic exchange of information. The EU is a world leader in this respect. Automatic exchange of information between Member States was conceived as early as 2003 and implemented in the Savings Taxation Directive in 2005. Thanks to this directive, Member States exchange information on non-resident taxpayers to the value of EUR 20 billion. In addition to this, the Administrative Cooperation Directive which entered into force in January this year provides for automatic exchange of information on a wide range of revenues. Recently, the United States has also introduced this principle in its FATCA agreements. Working together through the established EU system allows Member States to minimise additional burdens for tax administrations and financial institutions and to ensure quick and consistent application throughout the EU.

The Commission has also developed electronic formats for exchange of information and secure channels of communication. Information exchange is only possible with specialised IT support. The Commission has already developed standard computerised formats for the automatic exchange of information and channels for exchanging information under the Savings Taxation Directive. This will need to be continuously updated and extended to cover other types of income under the Administrative Cooperation Directive.

Box 2: The European Union's toolbox to fight against tax fraud and tax evasion

- **The EU Savings Taxation Directive (in force since 2005) lays down the principle of automatic exchange of information**. In 2008, the Commission proposed to close loopholes in the directive by extending it to investment funds, pensions, innovative financial instruments and payments made through trusts and foundations. The directive is pending for adoption by the Council.

- **EU agreements on savings with Switzerland, Andorra, Monaco, Liechtenstein and San Marino (in place since 2005)** aim at ensuring a level playing field between the EU and its neighbours. In July 2011, the Commission asked the Council for a mandate to open negotiations with these five countries, to adapt the scope of these agreements to the revised EU Savings Directive. The Council has not yet agreed to grant the mandate.

- **The Administrative Cooperation Directive in the field of direct taxation provides for the automatic exchange of information in five new areas from 2015** (income from employment, directors' fees, life insurance products not covered by other EU instruments, pensions, and ownership of and income from immovable property) based on available information.

- **The Regulation on administrative cooperation in the field of VAT has been in force since 2012**. The EU is a pioneer in this field, which governs the way tax and customs offices in Member States collect and share information with other Member States on VAT. It also enhances the databases on VAT-taxable persons and their intra-Community transactions to detect and reduce tax fraud in this area.

- **The new Directive on mutual assistance for the recovery of taxes, in force since 2010,** improves the capacity of Member States in cross border collection of taxes. It permits enforcement in another Member State and the reinforcement of the possibility to take precautionary measures in another Member State to recover the claims that are not settled promptly by taxpayers.

- **The Quick Reaction Mechanism to fight VAT fraud was proposed by the Commission in July 2012**. Carousel fraud ("missing intra-community trader fraud") is one of the most prevalent types of cross-border fraud in the area of VAT. The mechanism proposed by the Commission provides for an emergency procedure enabling the Commission to authorise Member States to apply an exception to the general rule in intra-community transactions within a month of discovering a large VAT fraud.

- **The VAT Reverse Charge Directive** was proposed by the Commission in 2009 and partially adopted in March 2010 (on CO2 allowances only). The adoption of the remaining part of the proposal for a Directive would allow Member States to apply the reverse charge mechanism to supplies of several types of goods and services for which carousel fraud is already known to affect several Member States.

- **The Commission's Action Plan to further strengthen the fight against evasion and avoidance (December 2012)** includes more than 30 measures covering individuals, companies and uncooperative jurisdictions. As part of the Action Plan, the Commission launched a Platform for Tax Good Governance, bringing together governments, NGOs and business to steer the implementation of the Action Plan.

- **The Commission has proposed legislation to update the framework on Anti-Money Laundering and fund transfers (February 2013) to reinforce the EU's existing rules** by extending the scope and addressing new threats and vulnerable areas. The proposal also introduces clearer mechanisms for the identification of beneficial owners including those behind entities. The proposal is pending before the European Parliament and the Council.

- **New EU rules on bank capital requirements** will increase transparency regarding the operations of multi-national banks. Financial institutions will have to disclose information on 6 new items including turn-over, profits and taxes in each EU country and in each third country in which they have operations. EU legislation on alternative investment fund managers also contains important conditions on tax compliance and cooperation that must be fulfilled before a fund can be marketed in the EU.

- Recently agreed changes to the **EU accounting rules will introduce a system of Country-by-Country Reporting (CBCR).** It will cover privately-owned large companies in the EU or companies listed in the EU that are active in the oil, gas, mining or logging sectors. Reporting taxes, royalties and bonuses paid by a multinational to a host government, is an important step forward for tax transparency as well as for the fight against corruption and money laundering.

Although the existing tools have improved information exchange considerably, Member States are not yet using them effectively and comprehensively.

Some of the Commission's proposals are still pending for adoption despite having been on the table for several years. And the potential of many of the existing legal instruments and practical mechanisms has not been fully harnessed by the tax administrations of Member States. The priority now is for Member States to make full use of this toolbox and to implement what has been agreed in a diligent and coordinated way. Member States have full sovereignty over the collection of their taxes, the functioning and consistency of their tax laws and tax administrations, and the fight against tax fraud. The EU's tools can only help if there is the political will and the administrative capacity to make full use of them. Whilst the Commission assists Member States in their efforts by providing them with the practical tools and instruments, the onus is on them to engage in effective administrative cooperation.

Box 3: What has to be done at EU level?

- **The Council should adopt the proposed revision to the Savings Taxation Directive and give the Commission the mandates to negotiate equivalent improvements in the existing agreements with neighbouring countries**.
- **The draft EU-Liechtenstein anti-fraud and tax cooperation agreement** and the mandate to open negotiations with other EU neighbouring countries should also be adopted by the Council.
- Pending **measures to counter VAT fraud** in particular the Quick Reaction Mechanism should also be adopted by the Council.
- **In line with the Commission's Action Plan on strengthening the fight against tax fraud and tax evasion of December 2012, Member States should prioritise concrete follow-up**.
- **The principle of automatic exchange of information within the EU should be extended to all relevant types of income.** The European Commission will present a legislative proposal to amend the EU Directive on Administrative Cooperation in order to expand the scope of automatic exchange of information at EU level. The aim will be to ensure automatic exchange of information on dividends, capital gains and other income from 2015, the date at which automatic exchange will also become the EU norm for income from employment revenues, directors' fees, pensions, life insurance and revenue from immoveable property. The proposal will also address the current option that tax administrations have of not reporting information that is not "available". In parallel, and as a matter of urgency, work will be taken forward at technical level by extending to all relevant forms of income the current standard IT formats and secure communication channels used to exchange information.

4. Action to promote good global tax governance

The EU should also take a leading role in promoting good tax governance and in particular the automatic exchange of information globally. The Commission is driving international efforts to combat tax fraud and evasion. The upcoming G8 (17-18 June) and G20 summits (5-6 September) will provide important opportunities to make progress on tax avoidance, evasion and anti-money laundering at international level. The OECD, supported by G20 and G8, is also working in this area.

Building on EU arrangements, a strong and coordinated EU position in the G8, G20 and OECD can help ensure that automatic exchange of information becomes the new global standard.

Box 4: The EU as a driver for action at international level

- **The EU should take a leading role in the international arena to promote the principles of Good Governance in the tax area and in particular the automatic exchange of information and fair tax competition principles.**

- **Automatic information exchange should become the new international standard**. The EU should agree on an ambitious and coordinated position to make automatic exchange of information a global standard guiding international taxation. In particular, the EU should speak with one voice in the G8, the G20 and the OECD so as to secure a firm commitment to the development of new international rules that takes into account existing EU arrangements for automatic information exchange.

- **The EU must continue to assist developing countries committed to good tax governance principles** to build up robust tax administrations by cooperating and providing technical assistance to them.

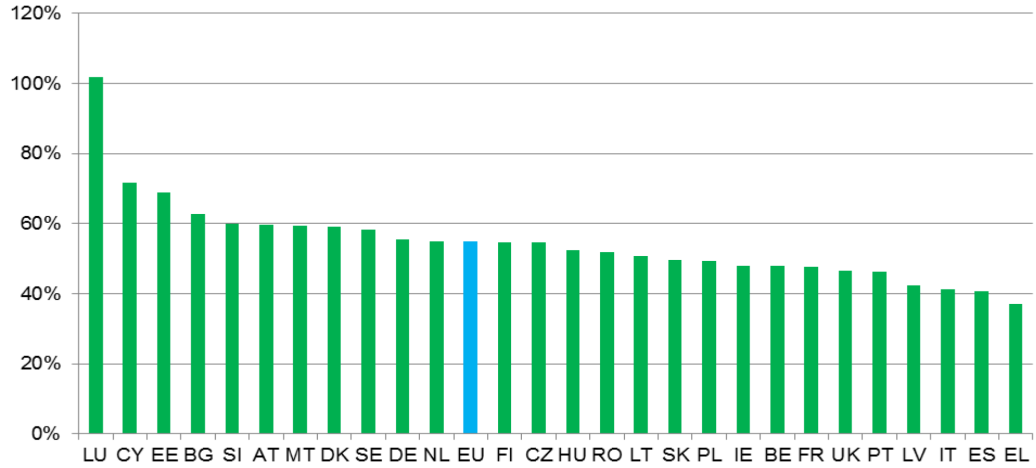
- **The EU should coordinate its position in the G20 discussions** on base erosion and profit shifting (BEPS) in line with the direction provided in the European Council conclusions and building on the developments within the EU in tackling tax havens and aggressive tax planning.

- The Commission will work to ensure **interconnectivity and interoperability between the EU's IT information exchange systems** and the US FATCA system and the global standard being developed by the OECD. This will reduce administrative burdens on operators and on administrations.

ANNEX

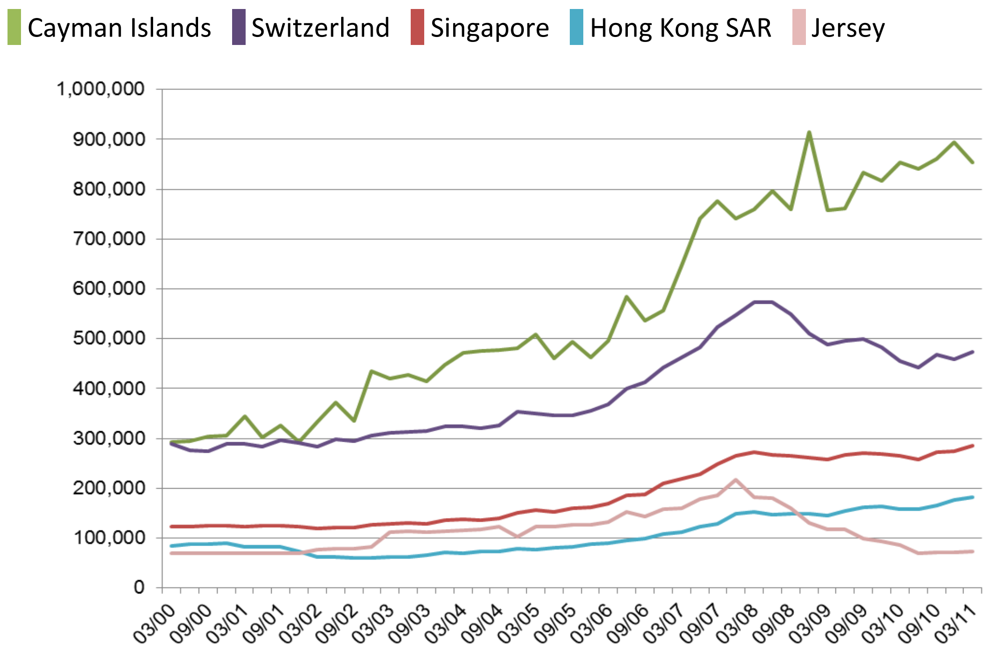
Member States are only collecting around one half of the VAT revenue available to them

Actual VAT revenue in 2010 (% of theoretical revenue at standard rates) [2]



Offshore financial centres with strong banking secrecy laws continue to dominate the international cross-border deposits market

Trends in foreign non-bank deposits with banks in major selected non EU financial centres (millions of US dollars) [3]



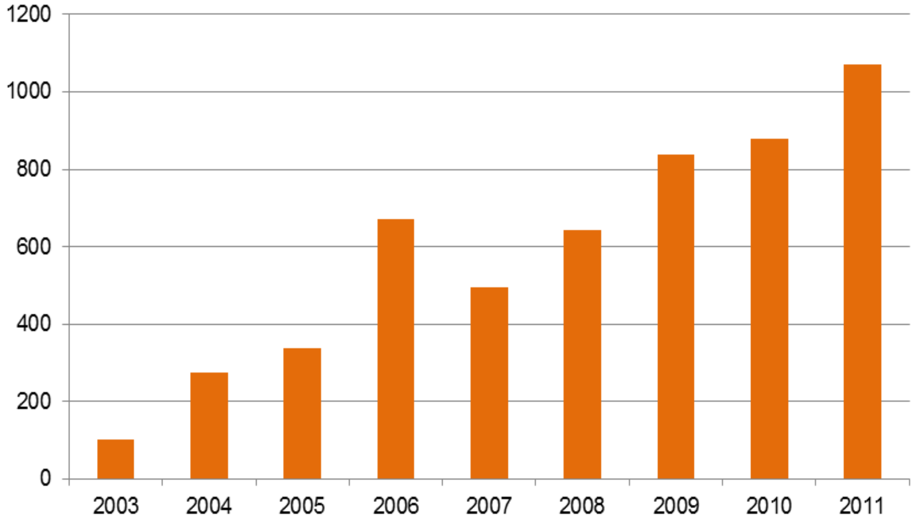
[2] Source: European Commission; Taxation Trends 2012 edition.
[3] Source: BIS public aggregate data

Cooperation brings substantial economic benefits to Member States

Since 2003 the amounts of tax recovered cross border under the recovery Directive have increased more than tenfold[4]

Evolution of the tax amounts recovered on the basis of EU recovery assistance

(Index: 2003 = 100)



[4] Source: European Commission