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COMMISSION RECOMMENDATION

of 6.12.2012

on aggressive tax planning

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 292 thereof,

Whereas:

- (1) Countries around the world have traditionally treated tax planning as a legitimate practice. Over time, however, the tax planning structures have become ever-more sophisticated. They develop across various jurisdictions and effectively, shift taxable profits towards states with beneficial tax regimes. A key characteristic of the practices in question is that they reduce tax liability through strictly legal arrangements which however contradict the intent of the law.
- (2) 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 (e.g. the same loss is deducted both in the state of source and residence) and double non-taxation (e.g. income which is not taxed in the source state is exempt in the state of residence).
- (3) Member States find it difficult to protect their national tax bases from erosion through aggressive tax planning, despite important efforts. National provisions in this area are often not fully effective, especially due to the cross-border dimension of many tax planning structures and the increased mobility of capital and persons.
- (4) With a view to moving to a better functioning of the internal market, it is necessary to encourage all Member States to take the same general approach towards aggressive tax planning, which would help diminishing existing distortions.
- (5) To this end, it is necessary to address instances in which a taxpayer derives fiscal benefits through engineering its tax affairs in such a way that income is not taxed by any of the tax jurisdictions involved (double non-taxation). The persistence of such situations can lead to artificial capital flows and movements of taxpayers within the internal market and thus harm its proper functioning as well as erode Member States' tax bases.
- (6) In 2012 the Commission carried out a public consultation on double non-taxation in the internal market. Since it is not possible to address all the issues covered by that consultation through one single solution, it is appropriate, as a first step, to deal with the issue which is linked to certain frequently used tax planning structures that take

advantage of mismatches between two or more tax systems and often lead to double non-taxation.

- (7) States often undertake, in their double taxation conventions, not to tax certain items of income. In providing for such treatment, they may not necessarily take account of whether such items are subject to tax in the other party to that convention, and thus whether there is a risk of double non-taxation. Such risk may also occur if Member States unilaterally exempt items of foreign income, irrespective of whether they are subject to tax in the source state. It is important to address both situations in this Recommendation.
- (8) As tax planning structures are ever more elaborate and national legislators are frequently left with insufficient time for reaction, specific anti-abuse measures often turn out to be inadequate for successfully catching up with novel aggressive tax planning structures. Such structures can be harmful to national tax revenues and to the functioning of the internal market. Therefore, it is appropriate to recommend the adoption by Member States of a common general anti-abuse rule, which should also avoid the complexity of many different ones. In this context, it is necessary to take account of the limits imposed by Union law with regard to anti-abuse rules.
- (9) So as to preserve the autonomous operation of existing Union acts in the area concerned, this Recommendation does not apply within the scope of Council Directive 2009/133/EC¹, of Council Directive 2011/96/EU² and of Council Directive 2003/49/EC³. A revision of those Directives with a view to implement the principles underlying this Recommendation is currently considered by the Commission,

HAS ADOPTED THIS RECOMMENDATION:

1. Subject matter and scope

This Recommendation addresses aggressive tax planning in the area of direct taxation.

It does not apply within the scope of Union acts whose operation could be affected by its terms.

2. Definitions

For the purpose of this Recommendation, the following definitions apply:

- (a) "tax" means income tax, corporation tax and, where applicable, capital gains tax, as well as withholding tax of a nature equivalent to any of these taxes;
- (b) "income" means all items which are defined as such under the domestic law of the Member State which applies the term and, where applicable, the items defined as capital gains.

3. Limitation to the application of rules intended to avoid double taxation

¹ OJ L 310, 25.11.2009, p. 34.

² OJ L 345, 29.12.2011, p. 8.

³ OJ L 157, 26.6.2003, p. 49.

3.1. Where Member States, in double taxation conventions which they have concluded among themselves or with third countries, have committed not to tax a given item of income, Member States should ensure that such commitment only applies where the item is subject to tax in the other party to that convention.

3.2. To give effect to point 3.1, Member States are encouraged to include an appropriate clause in their double taxation conventions. Such clause could read as follows:

'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'.

In case of multilateral conventions, the reference to the "other contracting State" should be replaced by a reference to the "other contracting States".

3.3. Where, with a view to avoid double taxation through unilateral national rules, Member States provide for a tax exemption in regard to a given item of income sourced in another jurisdiction, in which this item is not subject to tax, Member States are encouraged to ensure that the item is taxed.

3.4. For the purposes of points 3.1, 3.2 and 3.3 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.

4. General Anti-Abuse Rule

4.1. To counteract aggressive tax planning practices which fall outside the scope of their specific anti-avoidance rules, Member States should adopt a general anti-abuse rule, adapted to domestic and cross-border situations confined to the Union and situations involving third countries.

4.2. To give effect to point 4.1, Member States are encouraged to introduce the following clause in their national legislation:

'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'.

4.3. For the purposes of point 4.2 an arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event. An arrangement may comprise more than one step or part.

4.4. For the purposes of point 4.2 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 characterisation 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.

4.5. For the purposes of point 4.2, the purpose of an arrangement or series of arrangements consists in avoiding taxation where, regardless of any subjective intentions of the taxpayer, it defeats the object, spirit and purpose of the tax provisions that would otherwise apply.

4.6. For the purposes of point 4.2, a given purpose is to be considered essential where any other purpose that is or could be attributed to the arrangement or series of arrangements appears at most negligible, in view of all the circumstances of the case.

4.7. In determining whether an arrangement or series of arrangements has led to a tax benefit as referred to in point 4.2, national authorities are invited to compare the amount of tax due by a taxpayer, having regard to those arrangement(s), with the amount that the same taxpayer would owe under the same circumstances in the absence of the arrangement(s). In that context, it is useful to consider whether one or more of the following situations occur:

- (g) an amount is not included in the tax base;
- (h) the taxpayer benefits from a deduction;
- (i) a loss for tax purposes is incurred;
- (j) no withholding tax is due;
- (k) foreign tax is offset.

5. Follow-up

Member States should inform the Commission on the measures taken in order to comply with the present Recommendation, as well as on any changes made to such measures.

The Commission will publish a report on the application of this Recommendation within three years after its adoption.

6. Addressees

This Recommendation is addressed to the Member States.

Done at Brussels, 6.12.2012

For the Commission
Algirdas Šemeta
Member of the Commission