EU Launches New Initiative Targeting Tax Advisers (Part 1)

In a two-part article, Oliver R. Hoor of ATOZ Tax Advisers considers the EU's current anti-abuse measures and asks whether, in light of the public consultation which has been launched, there is a real need for a new initiative in this area by the European Commission.

Related articles:

- EU Launches New Initiative Targeting Tax Advisers (Part 2)

By Oliver R. Hoor
Oliver R. Hoor is a Tax Partner (Head of Transfer Pricing and the German Desk) with ATOZ Tax Advisers.

On July 6, 2022, the European Commission launched a public consultation regarding a proposal for council directive to tackle tax advisers and other professionals rendering tax advice (collectively referred to as "enablers") that facilitate tax evasion and aggressive tax planning.

Interested parties may provide their feedback until Oct. 12, 2022, in a questionnaire, the EU survey: "Proposal for a Council Directive to tackle the role of enablers that facilitate tax evasion and aggressive tax planning in the European Union (Securing the Activity Framework of Enablers—SAFE)."

This two-part article discusses the current EU anti-abuse measures in place, provides an overview of the questionnaire, and analyses to what extent there is a real need for this initiative.

The Current EU Tax Landscape

The European and international tax landscape has undergone a dramatic transformation over the last years. Following the Organisation for Economic Cooperation and Development base erosion and profit shifting (BEPS) project, the European Commission adopted several EU directives that aimed to tackle perceived tax evasion and tax avoidance.

The two Anti-Tax Avoidance Directives (ATAD and ATAD II) provided for a number of strict anti-abuse provisions that had to be transposed into the domestic tax laws of EU member states. The fifth amendment of the Directive on Administrative Cooperation in the field of (direct) taxation (DAC6) resulted in the introduction of the mandatory disclosure regime that requires reporting on potentially aggressive tax planning schemes.

At the end of 2021, the European Commission further released a draft directive regarding the misuse of EU shell entities—entities lacking a minimum level of substance for tax purposes—ATAD III, also referred to as the "unshell directive".

Other important changes to the international tax landscape have been advanced by the OECD. The multilateral instrument resulted in the implementation of various anti-abuse provisions such as the principal purpose test (PPT) in covered bilateral tax treaties. In 2017 and 2020, the OECD Transfer Pricing Guidelines were revised in accordance with the guidance developed as part of the OECD's (follow up) work on BEPS Actions 8–10 and 13.

Hence, the tax authorities of EU member states already have a comprehensive arsenal of anti-abuse rules that allow them to tackle any kind of abusive situation, as well as reporting requirements that should allow them to be aware of any residual abuse.

A New EU Initiative

Nevertheless, despite all these changes, the European Commission takes the view that tax advisers are still designing, marketing, and assisting in the creation of tax schemes in non-EU countries that erode the tax base of EU member states. The Commission states in its document *Call for evidence for an impact assessment* that while the unshell directive will ensure that EU shell entities are unable to benefit from any tax advantages, a follow-up initiative is still needed to respond to the challenges linked to non-EU shell entities.

The purpose of the current initiative is to establish procedures and compliance measures to be adhered to by tax advisers and other professionals that render tax advisory services, in order to prevent them from setting up complex structures in non-EU countries that erode the tax base of member states through tax evasion and aggressive tax planning.

Tax Evasion and Aggressive Tax Planning

The Commission's questionnaire states: "Complex structures, which typically include cross-border arrangements that could result in tax evasion or aggressive tax planning may be designed by some intermediaries that provide tax advisory services." However, is this really true?

Tax evasion involves intentional, fraudulent conduct aimed at the evasion of taxes by illegal means. In these cases, taxpayers deliberately misrepresent or conceal the true state of their affairs from the tax authorities in order to reduce their tax liability.

Examples of tax evasion include dishonest tax reporting—for instance, the non-declaration or under-reporting of income or the overstating of expenses, faked transactions to reduce tax payments, and transfer pricing manipulations. Tax evasion involves a violation of law, is a criminal offense and may, therefore, be tackled by enforcement of the existing law (once discovered by the competent tax authorities).

While taxpayers engaging in tax evasion face severe penalties, and potential imprisonment, tax advisers involved in tax evasion will likely be punished by the withdrawal of their professional license and charged with a crime. These severe consequences deter (exceptions aside) taxpayers and tax advisers from being involved in practices that may be interpreted as tax evasion.

The term "aggressive tax planning" has been defined in the Commission Recommendation of Dec. 6, 2012 on Aggressive Tax Planning (2012/772/EU) as follows:

"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)."

Accordingly, aggressive tax planning is present in the following two situations:

- Taxpayers take advantage of the technicalities of a tax system; or
- Taxpayers take advantage of mismatches between two or more tax systems.

Both situations have in common that the tax treatment would not be consistent with the intention of the legislator.

However, the tax treatment of an arrangement is consistent with the intention of the legislator when the tax treatment relies on the application of explicit tax law (which is the expression of the intention of the legislator) or, in a cross-border context, does not take advantage of mismatches in the tax system of two or more jurisdictions.

The transposition of ATAD I and ATAD II resulted in the adoption of the following anti-abuse legislation by EU member states:

a) interest limitation rules
b) controlled foreign company (CFC) rules
c) exit tax rules
d) general anti-abuse Rule (GAAR), and
e) hybrid mismatch rules.

The specific anti-abuse rules in a)–c) target perceived vulnerabilities of domestic tax laws and resulted in a substantial harmonization of the tax laws of EU member states.

As regards aggressive tax planning, the GAAR allows tax authorities to tackle non-genuine arrangements which take advantage of technicalities of the applicable tax law, whereas the hybrid mismatch rules eliminate mismatch outcomes (double deduction and deduction without inclusion outcomes) that are the result of mismatches in the tax systems of two or more jurisdictions.

Tax benefits available under applicable tax treaties may be challenged in accordance with anti-abuse provisions such as the PPT, eliminating the possibility of taxpayers engaging in aggressive tax planning.

The revised OECD Transfer Pricing Guidelines include new guidance that aims to align transfer pricing outcomes with value creation. Moreover, the amended guidance provides tax authorities with additional room to challenge the transfer pricing of intra-group transactions and to disregard or re-characterize certain intra-group transactions.

Consequently, the transposition of the anti-tax avoidance directives, the modification of the bilateral tax treaty network, and the revision of the OECD Transfer Pricing Guidelines, virtually removed the possibility of using aggressive tax planning strategies and provided the tax administrations with far-reaching powers to challenge taxpayers.

Part two of this article will consider the content of the EU questionnaire and the issue of whether there is a need for further initiatives in the current tax landscape.

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EU Launches New Initiative Targeting Tax Advisers (Part 2)

In a two-part article, Oliver R. Hoor of ATOZ Tax Advisers considers the EU's current anti-abuse measures and asks whether, in light of the public consultation which has been launched, there is a real need for a new initiative in this area by the European Commission. In part two, he discusses the detail of the consultation, and looks at the existing measures targeting tax evasion and avoidance.

Related articles:

- EU Launches New Initiative Targeting Tax Advisers (Part 1)

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Part two of this two-part article will consider the European Commission's public consultation on a further initiative against tax evasion and aggressive tax planning. It also will discuss whether such measures are necessary in the context of the current available measures addressing perceived abuse under domestic tax laws and tax treaties, transparency in tax matters, and tax reporting.

The Public Consultation

Following the release of its "Call for evidence for an impact assessment" (a document that explains the new initiative), the European Commission launched a public consultation and invited interested parties to share their views by Oct. 12, 2022, in a questionnaire. The questionnaire is divided into three sections relating to:

- problem definition;
- ways to tackle the role of "enablers" in facilitating tax evasion and aggressive tax planning; and

- enforcement of the measure.

Most of the questions require respondents to either (strongly) agree or (strongly) disagree with a statement. As such, the questionnaire leads the respondents around a certain narrative and limits the possibility to answer freely. This tactic has already been deployed in the public consultation regarding ATAD III and allows the European Commission to skew the interpretation of the responses.

Moreover, while the document “Call for evidence for an impact assessment” identifies as an issue the setting up of complex tax structures “in non-EU countries,” the questionnaire is drafted much more broadly (i.e., no distinction is made between EU and non-EU structures).

Problem Definition

The first part of the questionnaire focuses on problem definition. While the author welcomes public consultations, the nature and organization of this raises several issues.

For example, interested parties have to specify to what extent they agree with the following statements:

- “Despite all measures taken by the EU and member states in this area, tax evasion and aggressive tax planning continue to be a substantial problem in the European Union.” (3.1 of the questionnaire)
- “The issue of tax evasion or aggressive tax planning has continued to increase recently.” (3.3 of the questionnaire)
- “Enablers play an important role in facilitating tax evasion and aggressive tax planning.” (3.5 of the questionnaire)

The EU toolbox to fight aggressive tax planning has recently been enhanced, and new tools came into effect in 2019 and 2020. Therefore, respondents will likely not have any empirical data in this respect. Nonetheless, it seems safe to assume that the introduction of comprehensive anti-abuse rules in domestic tax laws, bilateral tax treaties, and the OECD Transfer Pricing Guidelines should significantly reduce the magnitude of perceived aggressive tax planning as taxpayers may merely comply with explicit tax legislation.

Hence, it is apparent that the European Commission does not know if there even is an issue, but asks interested parties for their “gut feeling” whether there is a need for further action.

This immediately raises the question as to whether the Commission has authority to intervene. The pretextual legal basis for the initiative would be Article 115 of the Treaty on the Functioning of the European Union (TFEU) on the approximation of laws of the member states that directly affect the establishment or functioning of the internal market. It is difficult to understand, however, how one decides on the existence of a problem by asking a self-selecting but otherwise unqualified random selection of members of the public.

Furthermore, while the questionnaire is addressed to all “stakeholders,” many of the questions can only be answered by people with a strong knowledge of international taxation. For example, the question regarding the criteria to be considered when assessing the existence of aggressive tax planning, includes:

- the main business rationale/purpose behind the company structure
- other business rationale/purpose behind the company structure;
- minimum economic substance of the entities used in the structure;
- tax advantage obtained;
- use of preferential tax regimes/tax treaties/mismatches in national legislations across countries involved in the structure;
- other (to be specified).

The European Commission requests an assessment of each of these criteria to understand how relevant they are. However, these highly technical questions should be answered by Commission experts; they do not lend themselves to the format of public surveys.

Options Considered

The European Commission considers a range of policy options that may lead to a legislative initiative, including:

- Option 1: Requirement for all tax advisers to carry out dedicated due diligence procedures. This option would involve a prohibition on tax advisers (and other professionals rendering tax advisory services) from assisting in the creation of arrangements abroad that facilitate tax evasion or aggressive tax planning and a requirement to verify whether the arrangement or scheme leads to tax evasion or aggressive tax planning.
- Option 2: Prohibition on facilitating tax evasion and aggressive tax planning, combined with due diligence procedures and a requirement for tax advisers to register in the EU. The second option would aim to make sure that only registered tax advisers could provide tax advisory services to EU taxpayers or residents. In cases of non-compliance, tax advisers may be removed from the registry.
- Option 3: Code of conduct for all tax advisers. This option would involve the requirement for all tax advisers to follow a code of conduct that obliges tax advisers to ensure that they do not facilitate tax evasion or aggressive tax planning.

Finally, a new measure might be introduced requiring EU taxpayers (both individuals and legal persons) to declare in their annual tax returns any participation above 25% of shares, voting

rights, ownership interest, bearer shareholdings, or control via other means (the level commonly used in the EU anti-money laundering legislation) in a non-listed company located outside of the EU.
On each of these options, the European Commission asks for an assessment and/or how effective the measure would be.

Enforcement of the Measure

With regard to the enforcement of the potential measure, respondents have to specify whether they (strongly) agree or (strongly) disagree with the statement that "monetary penalties are an adequate means to appropriately sanction and deter tax advisers from facilitating tax evasion and aggressive tax planning."

Moreover, respondents that either strongly agree or agree with this statement have to determine the type of monetary penalties that would be adequate to deter tax advisers from helping their clients to evade or avoid taxes. Here, respondents may choose between "a proportion of their fees," "a proportion of amounts evaded on behalf of their clients," "an absolute fixed number," or "other" to be specified by the respondents.

Other Measures Focusing on Tax Evasion and Tax Avoidance

This new initiative of the European Commission is not the only initiative focusing on transparency regarding potentially aggressive tax planning. The mandatory disclosure regime (MDR) already requires tax intermediaries to analyze cross-border arrangements and report potentially aggressive tax planning schemes.

Moreover, the draft "unshell directive" focuses on the substance of companies that are resident for tax purposes in EU member states. If adopted, this directive would require EU member states to introduce both new reporting obligations and anti-abuse rules targeting shell entities.

We provide below an overview of the MDR and the draft unshell directive, after which we will analyze the overlap with existing anti-abuse legislation and the new initiative of the European Commission.

The Mandatory Disclosure Regime (DAC6)

Under the MDR, tax intermediaries such as tax advisers, accountants, and lawyers that design, promote, or provide assistance in regard to certain cross-border arrangements have to report these to the tax authorities. Since the implementation of the MDR, the analysis of potential reporting obligations has become an integral part of each and every tax analysis.

The MDR operates through a system of “hallmarks” that may trigger reporting obligations, and the main benefit test (MBT) that functions as a threshold requirement for many of these hallmarks. As such, the MBT should filter out irrelevant reporting and enhance the usefulness of the information collected, because the focus will be on arrangements that have a higher probability of truly presenting a risk of tax avoidance.

When determining whether advice on a particular arrangement is reportable under the MDR, it is first necessary to analyze whether the arrangement has a cross-border dimension. This would be the case when an arrangement concerns either more than one EU member state or an EU member state and a third country.

Cross-border arrangements may be reportable if they contain at least one of the hallmarks listed in the Appendix to the DAC6 Directive. These hallmarks describe characteristics or features of cross-border arrangements that might present an indication of a potential risk of tax avoidance.

When at least one of the hallmarks is fulfilled, it has to be verified whether the hallmark is subject to the MBT. If this is not the case, there is an automatic reporting obligation under the MDR. When the hallmark is subject to the MBT, it is necessary to perform a comprehensive analysis of all relevant facts and circumstances in order to determine whether the main benefit or one of the main benefits was the obtaining of a tax advantage.

The Unshell Directive (ATAD III)

The draft unshell directive would apply to all undertakings that are considered tax resident and are eligible to receive a tax residence certificate in a member state regardless of their legal forms. The determination of shell entities under the proposed reporting regime involves a series of tests and may, in some cases, require a comprehensive analysis.

However, only entities that meet certain gateway criteria would have to report in their tax returns on specific indicators of minimum substance. When an entity satisfies all these indicators, there would be a presumption that the entity has minimum substance. Otherwise, there would a rebuttable presumption that the entity is a shell entity.

The proposed reporting regime further places an obligation on the member states to exchange in a timely manner comprehensive information on entities subject to reporting and on entities that rebut the presumption of a lack of substance or are exempt from obligations under the draft directive.

The classification as a shell entity would have far-reaching (tax) consequences in the residence state of the entity and the other member states involved.

Overlapping Scopes and Obligations

Whenever a taxpayer obtains a tax benefit, it must be analyzed whether such benefit might be challenged in accordance with existing anti-abuse legislation. Tax benefits derived from aggressive tax planning may be denied in accordance with general and specific anti-abuse provisions under domestic tax law and bilateral tax treaties.

Tax advisers (and other tax intermediaries) further have to analyze potential reporting obligations under the MDR and anticipate potential reporting obligations under the unshell directive. While the MDR focuses on transactions (i.e., cross-border arrangements), the unshell directive focuses on the substance of entities resident in EU member states.

However, when analyzing potential reporting obligations under the MDR, it may also be necessary to analyze whether the entities involved have appropriate substance. More precisely, when a cross-border arrangement meets a hallmark that is subject to the MBT, the analysis as to whether the MBT is met requires an analysis of the substance of the entities involved.

When an entity is classified as a wholly artificial arrangement, the MBT would very likely be met, and reporting will need to be made to the local tax authorities that share this information in a central database that is accessible to the tax authorities of all EU member states. Accordingly, both reporting regimes have a certain overlap.

Whatever the outcome of the new initiative, it may only have a very limited effect in practice, as tax advisers already have to ensure that their advice may not be interpreted as aggressive tax planning—which can be tackled under existing anti-abuse legislation.

Conclusion

The current initiative of the EU Commission targets tax advisers and other professionals that render tax advisory services which have been labeled collectively as “enablers.” However, in an ever-changing international tax environment, taxpayers must rely on the advice of experts to ensure compliance with all applicable laws. Asset managers and multinationals further have a fiduciary duty toward their investors to explore opportunities to manage their overall tax liability within the limits of the law.

The existing anti-abuse legislation and reporting obligations under the MDR tackle aggressive tax planning analysis efficiently already. Thus, the question arises as to what meaningful purpose an additional measure might serve.

Considering the above, the question also arises whether the European Commission has a legal basis for this initiative. Direct tax legislation falls within the ambit of Article 115 of the TFEU, which stipulates that legal measures under that article shall be vested with the legal form of a directive. However, the EU's competences are governed and limited by the principles of subsidiarity and proportionality. As the new initiative does not seem to serve any real need, it is more than questionable if this initiative adheres to these principles.

It remains to be seen where we go from here. As we have recently seen some pushback from EU member states regarding the draft unshell directive, questioning the Commission's authority for action, the current initiative may also give rise to some controversial discussions.

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