REPLIES OF THE EUROPEAN COMMISSION

TO THE EUROPEAN COURT OF AUDITORS' SPECIAL REPORT

Combatting harmful tax regimes and corporate tax avoidance

The EU has established a first line of defence, but there are shortcomings in the way measures are implemented and monitored

Contents

This document presents the replies of the European Commission to observations of a Special Report of the European Court of Auditors, in line with Article 265 of the Financial Regulation and to be published together with the Special Report.

I. THE COMMISSION REPLIES IN BRIEF

Harmful tax regimes and corporate tax avoidance are economic phenomena that are evident at EU and global level. A tax regime is considered harmful when the regime has adverse effects, such as the erosion of foreign tax bases or the unfair distribution of tax burdens. Such regimes can lead to significant tax losses for EU Member States and distortions in the internal market.

Tackling tax avoidance and ensuring fair tax competition continues to be a key EU priority. The EU has put a legal framework in place and uses other supporting instruments to combat harmful tax regimes and corporate tax avoidance as a first line of defence. The Commission is responsible for enforcing EU law, monitoring and coordinating Member States' actions.

A number of directives have been adopted at the EU level to ensure that these consensual policy objectives lead to concrete action and standard setting, including the Anti-Tax Avoidance Directive (ATAD) and the Directive on administrative cooperation in the field of taxation (DAC), with differing objectives.

The ATAD aims to strengthen the average level of protection against aggressive tax planning by laying down rules intended to prevent the erosion of tax bases in the internal market and the shifting of profits out of the internal market, as well as create a fair and transparent tax environment across Member States by harmonising tax avoidance rules. The directive addresses various forms of tax avoidance, particularly aggressive tax planning strategies.

The DAC established the legal framework for administrative cooperation in the field of direct taxation in the EU and requires all Member States to share certain tax-related information with each other. The 5th amendment to the directive (DAC6) introduced mandatory disclosure obligations for potentially harmful cross-border arrangements to further strengthen tax transparency and combat aggressive tax planning.

The Directive on Tax Dispute Resolution Mechanisms (TDRD) provides a mechanism for taxpayers to have redress in instances of double taxation. When faced with double taxation, taxpayers can start resolution process in a given Member State without a choice as to which Member State they can start the processes in. As such this Directive brings benefits to the tax system but its main purpose is not to combat harmful tax regimes and corporate tax avoidance in the EU.

The EU regulatory framework is further assisted by the Code of Conduct Group, an intergovernmental body for tackling unfair tax competition, within the EU and beyond. This group has assessed the potential harmfulness of more than 400 tax measures to limit the effects of harmful tax competition. Around 100 measures have been assessed harmful and were afterwards brought in line with the Code principles. In addition, the Group has also issued guidance on specific matters to constrain the harmful effects of certain administrative practices or preferential regimes. By way of soft law, the guidance sets out the limits for Member States when designing specific preferential regimes, so that substance and transparency are ensured.

Many actions have been taken but the EU cannot rest on the laurels as tax competition continues to evolve. In this regard, the Commission adopted in 2021 a legislative proposal to counter the misuse of shell entities for tax purposes (UNSHELL). This is a critical element to reinforce the fight against aggressive tax planning and tax avoidance in the EU as it would help tax administrations identify companies with insufficient substance that may be used as a vehicle for aggressive tax practices. Finally, the implementation of the Pillar Two Directive in the EU, which ensures a minimum effective rate of taxation for multinational enterprises, will also help to contain some aggressive tax practices.

II. COMMISSION REPLIES TO MAIN OBSERVATIONS OF THE ECA

1. The EU legislative framework for taxation

The Commission notes the ECA's critical assessment of the lack of guidance to clarify legal ambiguities in the EU legislative framework examined. In this regard, the Commission needs to emphasise that the legislative process in direct taxation is governed by unanimity (Art. 115 TFEU). As a result, EU tax directives reflect carefully struck compromises in Council which could leave room for interpretation of the legal acts concerned. Against that background, the Commission acknowledges the coordination and monitoring role it must play in the implementation of the directives. The Commission recognises the value of guidelines, although non-binding, and has worked in the past with Member States to publish guidelines, for example for the DAC6 hallmarks. As DAC places the responsibility on Member States to act, together with the Commission, this means consensus is required for such guidelines. The Commission also organised meetings recently with Member States to assist them in the implementation of the Pillar 2 Directive. Some of the questions and answers discussed in these meetings are currently published on the website of Directorate General for Taxation and Customs Union[1] and can offer a useful source of interpretation for the business and national tax administrations.

With reference to DAC6 (paragraph 39), the Commission is carefully assessing the impact of the recent judgment delivered by the Court of Justice of the European Union (CJEU), C-623/22 Belgian Association of Tax Lawyers and Others[2], in removing ambiguities as regards enforcement and application of that Directive. Any further action to clarify any remaining potential legal ambiguities will take this judgement into account.

The Commission notes the finding of the ECA regarding comprehensive evaluations being overdue. The Commission fully supports evaluation and notes, in relation to an evaluation of DAC6 (paragraph 51), that the Commission sent a questionnaire to the Member States on Annex IV of DAC6 (including hallmarks and main benefit test) in 2022 to gather information needed for such an evaluation. As the implementation of DAC6 was postponed by six months in 24 out of 27 Member States, it was concluded that the evaluation of Annex IV should also be postponed by six months until the end of 2022. Given that this evaluation would have interfered with then-ongoing Council's discussions on DAC8, where DAC6 was concerned, it was not possible to complete it. In 2023, the Council adopted in DAC8 an amendment to align the timeline of the evaluation of DAC6 hallmarks with that of the DAC evaluation. Consequently, all provisions of DAC6 are now subject to the DAC evaluation currently underway.

It should be noted that the Court of Justice delivered its judgement in case C-623/22 Belgian Association of Tax Lawyers and Others, on 29 July 2024. Its conclusions will be taken into account to clarify DAC6 where deemed necessary. Having said this, the Commission will strive to issue guidance and also improve clarity in future legislation.

2. Member states' exchange of DAC6 information

The Commission understands that the ECA analysis and conclusions on exchanging DAC6 information are based on a specific sample of Member States that have been chosen based on specific criteria.

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[1] DG TAXUD webpage, see the Frequently Asked Questions on the 'Pillar 2' Directive, at the bottom of the page

[2] Judgement of the Court of Justice, 29 July 2024

However, the Commission is gathering quantitative data from questionnaires which shows a more positive picture for a number of Member States.

Based on the answers from Member States in 2023 (situation on 31/12/2022), 21 Member States used DAC6 data for risk assessment, 16 Member States used DAC6 data for audit (limited to specific categories of transactions, or for general audit), 10 Member States used DAC6 data for notification to generate disclosure or other use. The actual use is reflected by the matching process to identify the taxpayers concerned in place: in March 2023, the data set as a whole was routinely matched for identifying the relevant taxpayers in 15 Member States. In four Member States, some process and treatments were applied other than matching the whole data set. Therefore, in total 19 Member States out of 27 had already a complete and systematic process to match DAC6 data with their database in March 2023. Regarding the quality checks, in March 2023, 50% of the Member States had systems in place to ensure correctness of TIN, identification of taxpayers, and identifications of intermediaries. The Commission agrees that progress needs to be made in those Member States which lag behind.

Better use of data is a major priority for the Commission. A number of workstreams[3] have been established to this effect, including within Tax Administration EU Summit (TADEUS). This is also being considered in the current evaluation of the DAC, as the Commission considers this to be a key area for improvement.

The Commission agrees with the ECA's conclusions that the penalty regimes of Member States vary and takes note of the ECA's conclusions that no penalties have been so far applied in any of the Member States where visits were conducted (paragraphs 64 – 66).

3. Work of the Code of Conduct Group

The Commission is mindful of the limitations of this work and in 2022 the scope of the Group was broadened to cover tax features of general application and the notification process was streamlined. This stronger mandate came into effect in 2024. Future assessments will rely even more on notifications from other Member States or the Commission and not only on a self-notification from the Member State concerned.

The work of the Code of Conduct Group is an important tool in the fight against harmful tax practices and the Commission will continue to support the Group to maximise the deterrent effect of its actions.

The Commission agrees with the ECA that the flexibility of the chosen approach can limit the deterrent effect of the defensive measures applied by EU Member States against non-cooperative jurisdictions (i.e. those on the EU list (Annex I) since companies can choose to establish any business linked to non-cooperative jurisdictions in Member States which apply less strict defensive measures (paragraph 83). It is important to recall that the EU listing process is intergovernmental. This means that the Commission only proposes measures and EU Member States reach agreement within the Code of Conduct Group. The final decision is confirmed by the ECOFIN Council. In 2019, Member

[3] In response to a previous ECA audit, the Commission services and the Member States set up a team of experts at the end of 2022 who carried out a full review of the quality and use of DAC1-4 data (VISDAC) in all the Member States (26 visits were carried out by 16 September 2024). The project is due to deliver its overall conclusions by Q1 2025, outlining best practices and areas for improvement. At the same time, the Member States have launched a project under the umbrella of the Heads of Tax Administrations Summit (TADEUS) aimed at defining and implementing indicators to measure the performance of administrative cooperation in tax matters, including use of data and its outcome. Within this framework, a FISCALIS project bringing together tax administration data specialists has also been initiated to work more specifically on the enhancement of data and technical measures to improve data use. The conclusions of this project will complement previous initiatives.

States agreed Guidance for a coordinated framework of defensive measures and eventually chose the current toolbox approach during the discussions in the Code of Conduct Group meetings in 2024, as a way of combining further coordination and flexibility at the national level.

4. Monitoring the effects of the EU measures taken

The Commission agrees on the importance of understanding the scale of the loss of revenue due to tax evasion and avoidance, that a number of projects have been undertaken to estimate the impact of tax avoidance and evasion and that there is no single set of performance indicators used through the EU. The Commission also agrees that measuring tax gaps is a complex task and that combining multiple approaches can contribute to a more comprehensive understanding.

As acknowledged by the ECA, further to the 2018 study on corporate income tax revenue shortfalls and the 2019 and 2021 studies on tax evasion by individuals (paragraphs 86 and 87), the Commission has continued to work to analyse which method would be most suitable for the purpose of measuring and monitoring the tax gaps in the area of direct taxation. In addition to the on-going work on Corporate Income Tax (CIT) gap measurement in the context of TADEUS that is referenced by ECA in its report, a separate TADEUS subgroup looks at the Personal Income Tax (PIT) and Social Security Contributions (SSC) gap. Moreover, the Commission is preparing a report on CIT gap measurement and has commissioned a study on PIT/SSC Gap measurements.

As regards the measurement of performance itself in relation to Directive 2011/16/EU and more specifically DAC6, TADEUS has adopted a work plan aimed both at taking better account of data resulting from the automatic exchange of information and at putting in place indicators to better measure the effectiveness of cooperation. While not examined as part of this audit, it is also relevant to recall that in recent years, the Commission has used the Semester process and the Next Generation EU to address some national regimes leading to aggressive tax practices as identified in country specific recommendations to Member States. As part of the Recovery and Resilience Facility, the Commission agreed on specific milestones with most of the Member States concerned to address them. This process has been successful and is expected to lead to a significant reduction in Member States receiving a country specific recommendation on aggressive tax planning. Progress towards the achievement of country-specific recommendations issued as part of the European Semester and milestones relating to aggressive tax planning included in national Recovery and Resilience Plans are both closely monitored within the respective processes. These monitoring processes are thus also important in assessing the overall progress in fighting harmful tax regimes and corporate tax avoidance in the EU.

Moreover, it is worth noting that the Commission has worked diligently and introduced a more systemic and systematised approach to monitoring and following up on implementation of EU legislation in Member States during the period of time relevant to this audit. As a result of this work, the Commission launched more than 70 infringement procedures for either non-implementation (missing the deadline) or non-conformity of national legislation with the EU Directives in question. Most of the technical issues identified as a result of such infringements have since been addressed. The Commission will continue to remain vigilant in addressing legal impediments to the single market or violations of EU law, especially when these are linked to priorities such as the fight against tax avoidance, evasion or aggressive tax planning and base erosion.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS OF THE ECA

Recommendation 1 – Clarify the EU legislative framework

To ensure consistent application of the EU legislation by member states, the Commission should:

(a) in cooperation with the member states, develop its guidance, in particular provide guidelines for member states on interpreting the EU legislation aimed at fighting harmful tax regimes and corporate tax avoidance, performing risk analyses and using the tax information received,

(b) assess the need for possible amendments to the DAC 6 based on the results of the ongoing evaluation

(c) take into account in the preparation for its future evaluation the issues in the design of the TDRD as identified in this report to ensure that the tax dispute resolution mechanisms operate effectively.

(Target implementation date: (a) and (b) by end of 2026; (c) by end of 2028)

The Commission accepts recommendation 1a, noting that guidance is interpreted as non-legally binding. As regards DAC6, the Commission will issue guidance, as a result of the ongoing DAC evaluation and taking into account the recent judgement of the Court of Justice of the European Union, C-623/22 Belgian Association of Tax Lawyers and Others[4]. As regards future EU legislation, the Commission will endeavour to support Member States on a more systematic basis, including by developing guidance to ensure a consistent application of that legislation by Member States.

The Commission partially accepts recommendation 1b. The Commission will assess the need for adjustments to the legislation, following the ongoing DAC evaluation and taking into account the recent above-mentioned judgement of the Court of Justice of the European Union. The Commission will also work on improving the readability of the DAC by working on a codification once the text of the Directive becomes sufficiently stable. However, future legislative proposals cannot be prejudged; these require that they be tailored made to the specific situations and in agreement with Member States.

The Commission accepts recommendation 1c, as the Commission believes this later target implementation date of end 2028 is necessary to ensure a comprehensive evaluation is undertaken. The Commission will take into account, in the preparation for its future evaluation, the issues identified in the report.

Recommendation 2 – Improve the quality of DAC6 reports

To maximise the benefits of the automatic exchange of DAC 6 information with other member states, the Commission should make the data field for non-EU countries involved

[4] Judgement of the Court of Justice, 29 July 2024

in cross-border arrangements mandatory in the reporting scheme (if needed by a legislative proposal). Moreover, the Commission should update the DAC6 central directory architecture to make this information available to member states for every arrangement concerned.

(Target implementation date: end 2027)

The Commission partially accepts the recommendation as the proposed change would require an amendment of the DAC6 and the Commission cannot prejudge the future legislative proposals or their design. If adjustments to the legislation are proposed, they will likely integrate the conclusions of the ongoing evaluation. The Commission agrees with the ECA that the proposed change would potentially increase the benefit of the automatic exchange under DAC6 by enabling a better risk analysis on non-EU countries and is willing to explore with Member States the feasibility/opportunity of such a change and its impact on the central directory architecture to make this information available to Member States for every arrangement concerned.

Recommendation 3 – Ensure that the impact of penalties for non-compliance with DAC6 reporting obligations is adequate

To ensure that member states implement effective, proportionate and dissuasive penalties for non-compliance with DAC6 reporting obligations, the Commission should initiate infringement proceedings in those cases where there is sufficient evidence that member states are implementing a manifestly inadequate penalty system for breaches of the DAC6.

(Target implementation date: end 2026)

The Commission partially accepts the recommendation. The decision to take any infringement action against Member States on any matter depends on detailed analysis in each individual case of the issue and legislation at stake. The feasibility to initiate infringement proceedings depends on whether the requisite burden of proof for an infringement procedure could be reached and to what extent the existing jurisprudence would ultimately enable a legally defensible challenge before the Court of Justice of the EU. In addition, it must be noted that as part of the legislative process on DAC8, the Commission proposed in 2022 to introduce minimum penalties for reportable offenses. This amendment was ultimately not accepted by the Council. That said, the Commission is ready and willing to engage with Member States to assess the penalties regimes in place and identify ways in which these could be improved, in accordance with the obligations under EU legislation. Should such a dialogue fail, the Commission stands ready to use the instruments established in the Treaty.

Recommendation 4 - Enhance support to the Code of Conduct Group

To support the Code of Conduct Group more effectively in view of maximising the deterrent effect of its actions, the Commission should:

(a) propose to the Code of Conduct Group to agree on clear rules and limitations on grandfathering and rollback periods, and – if agreed by the Group – monitor compliance with them; and

(b) given its extended mandate, perform a yearly analysis of preferential tax measures and tax features of general application that are newly introduced by member states, and notify the Code of Conduct Group of potentially harmful ones based on a risk analysis.

(Target implementation date: (a) by the end 2026, (b) annually as from 2025)

The Commission accepts recommendation 4a, as it is in line with the current practice. Moreover, the current Guidance on Rollback agreed by the Code of Conduct Group dates from 2000. It mainly covers the timeline regarding rollback obligations once a preferential regime is assessed harmful, and lacks further details on the procedure. In this light, the Commission agrees that a revision is needed, also in view of the application of the Code principles in the EU listing area. The absence of guidance on grandfathering rules has indeed led to a variety of practices in the Group when agreeing such exceptions. Thus, the drafting of guidance with clear rules and specific limitations would lead to more equal treatment and increase transparency and tax certainty.

The Commission also accepts recommendation 4b to yearly notify potentially harmful measures to the Group on the basis of a risk analysis. The Commission is already systematically notifying potentially harmful measures to the Group in the accession process of new Member States or in horizontal exercises covering all Member States. In addition, the Commission launched an initiative to improve the notification procedure in June 2023. As a result, Guidance on how to notify newly introduced preferential regimes was adopted in June 2024. In line with these practices, the Commission is willing to further support the work of the Code of Conduct Group and notify potentially harmful regimes on the basis of a risk analysis on a yearly basis.

Recommendation 5 - Monitor the results and impacts of the fight against harmful tax regimes and corporate tax avoidance

The Commission should encourage and support member states to adopt a common performance monitoring framework, including performance indicators and quantitative targets, to measure the achievement of specific objectives in the fight against harmful tax regimes and corporate tax avoidance.

(Target implementation date: end 2026)

The Commission accepts this recommendation. This issue in practice is complex and delicate. The Code of Conduct Group is notified of corporate income tax regimes and the Commission has tried to include regimes related to personal income tax within its scope. However, this initiative has failed to reach consensus amongst the Member States.

By undertaking a more regular analysis of Member States' newly introduced tax measures, and notifying the Code of Conduct Group of potentially harmful ones based on a risk analysis (see recommendation 4b above), the Commission will contribute to the setting of a framework of performance monitoring, and the fight against harmful tax regimes and corporate tax avoidance. In this way, the tax measures with significant impact on the business location in the internal market would be brought to the attention of the Code of Conduct Group.

The Commission is continuing and consolidating its approach to monitoring the quality and the use of DAC6 data and is supporting initiatives by Member States and their tax administrations.

The Commission is supporting Member States and will continue to do so in analysing tax gaps, which could be one potential element of this performance monitoring framework. The Commission is already analysing which method would be most suitable for the purpose of measuring and monitoring tax gaps in the area of direct taxation.