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MEETING DOCUMENT

From:	Presidency
To:	Financial Counsellors - ECOFIN preparation
Subject:	Presidency Issues Note on 'Tax Certainty in a Changing Environment'

On behalf of the Presidency, delegations will find attached the Presidency Issues Note on 'Tax Certainty in a Changing Environment' for Session III on Saturday 8 April 2017 at the Informal Meeting of Finance Ministers in Valletta.

Please note that the format will be Ministers without Central Bank Governors, 1+3.

Tax Certainty in a Changing Environment

Informal EU Finance Ministers' Meeting, 7-8 April 2017, Valletta

Background

Since 2009, the international tax system has experienced rapid changes aimed at creating a more robust environment for global economic growth. These changes have fundamentally altered the international tax landscape, starting with the development of standards for tax transparency and then continuing with the project addressing Base Erosion and Profit Shifting (BEPS). Other changes may be faced in the near future that complement, and in some cases possibly disturb, this project.

The EU has played a very important role in effecting these changes, by championing and translating international standards and the BEPS recommendations into hard law, thereby equipping European tax administrations with better tools to fight tax evasion and avoidance. This harmonisation of tax rules at the EU level has helped to reduce tax uncertainty, yet it is now clear that an inconsistent application of BEPS rules at the international level risks being very counterproductive, by increasing that very uncertainty.

The downside of such major and rapid changes is that taxpayers and tax administrations may experience uncertainty. Considering the ultimate goal underpinning BEPS changes, which is to create stability and coherence in international taxation, it is pivotal that these are accompanied by an improvement in tax certainty for businesses, investors and tax administrations, all of which will continue to facilitate and promote trade and investment.

It is pertinent to note that the OECD BEPS Action Plan itself recognised this very need, which was again acknowledged by the G20 following the G20 Tax Policy Symposium held in Chengdu, China, on 23 July 2016. The OECD, working with the IMF, was mandated to come up with ways on how to reduce tax uncertainty, both from a macro-economic perspective as well as at a more practical level. Furthermore, the German Presidency of the G20 has chosen tax certainty as an important work stream for international cooperation on pro-growth tax policies. A report recently presented by the OECD and the IMF at the G20 Finance Ministers' meeting in Baden-Baden in March 2017, was welcomed by Finance Ministers and work will continue on this topic.

There is a clear recognition at the international level that tax certainty is not only needed but also desirable given its direct impact on investments. As with other tax-related initiatives aimed at achieving growth, the EU cannot fail to take action on this matter. Against this background, the Maltese Presidency of the Council would like to promote the debate on ways on how to improve tax certainty in support of the EU's attractiveness as a place for doing business. In this context it is noted that the Maltese Presidency has continued the legislative work on dispute resolution mechanisms, hybrid mismatches (agreement found in February 2017) and a common EU corporate tax base, all of which seek to contribute to tax certainty in one way or another.

Tax (Un)certainty: Questions to Address

Once there is agreement that tax certainty is desirable, it stands to reason that a number of questions concerning tax (un)certainty itself need to be addressed. The answers to these questions will have an effect on the quality and extent of the measures that EU Member States may wish to take in achieving the right balance between anti-avoidance measures on the one hand and tax certainty on the other.

A. What is tax certainty?

Reflection 1:

When one refers to or appeals for tax certainty, one is **not** referring to –

- complete immobility in the tax sphere. Changes in taxation are required to reflect changes in circumstances. However, one should work towards achieving a situation where change takes place at a reasonable pace such as to avoid unnecessary upheavals. Changes that are radical and disruptive should be avoided within the EU and appropriately tackled if coming from outside the EU;
- a system that deals with every possible transaction and interaction. Such a system would make it highly complex and unwieldy. In an already complex and changing world, the system will need a "safety net" for un-envisaged circumstances.

Reflection 2:

When speaking of tax certainty, one needs to consider that –

- tax law must be understandable and effective. Tax certainty has to do with both the knowledge of tax law, as well as the problem of communication in law. If tax laws is to be abided by, it must be able to guide the behaviour of its subjects and this is only possible if those subjects are aware of the detailed provisions of the law and are able to act on the basis of that knowledge;
- taxpayers' rights need to be guaranteed as these serve them as an instrument of protection. On the one hand, there needs to be stability of the legal effects assigned by law to acts performed in the past, while on the other, the future legal effects of present acts need to be calculable.

B. *Is tax certainty to be an end in itself or an instrument to realise other ends?*

Reflection 3:

Tax uncertainty has a direct effect not only on domestic investment but also on international trade and investment. It translates into risks and has the effect of increasing the cost of capital. In this sense, tax certainty is certainly an instrument for the realisation of other ends, particularly economic growth.

Reflection 4:

Respecting human dignity entails treating humans as persons capable of planning and plotting their future[1]. In this sense, providing tax certainty in order to allow tax planning could be considered an end in itself. Rights come with obligations, however, and assume a sense of individual responsibility on the taxpayers and their advisors' part. In this context, one needs to consider the effects of tax abuse and unbridled tax planning. Abusive tax planning comes at the cost of impeding other persons that same capability of plotting and planning their own future. Where tax planning comes at such a cost, tax certainty as an end in itself is problematic and needs to be controlled.

C. *Can tax uncertainty be reduced or avoided?*

Reflection 5:

Factors such as increased business activity, globalisation, enhanced digitalisation and the creation and use of intangible assets are changing the world's economy and its business models. With this kind of global economic change taking place, some level of tax uncertainty will always exist and consequently only relative certainty is attainable. In the final end, tax certainty is a question of measure. It is only a matter of knowing to what extent an attempt to achieve tax certainty can and should be rationally made through foreseeable determination.

D. *How and why can tax uncertainty arise?*

Reflection 6:

The rapid introduction of numerous pieces of tax legislation in quick succession could introduce elements of legal uncertainty in their interpretation, implementation and application. A certain amount of time is needed in order to properly formulate, assimilate and apply such legislation.

Reflection 7:

The implementation of tax transparency standards will have the effect of providing more information in the hands of tax administrations that may be used to conduct more tax audits. As a consequence, there could potentially be a significant increase in tax disputes between tax administrations. Such disputes create uncertainty. An effective and efficient mechanism for the resolution of such disputes would then be needed.

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[1] J. Raz, *The Authority of Law* (Oxford, Oxford University Press, 1979) at page 221.

Reflection 8:

Tax avoidance involves finding and exploiting ambiguities in tax rules, including in the treaty-based system of international taxation. In attempting to combat such schemes, legislators react by enacting new anti-avoidance legislation. It is plausible that such new legislation creates new complexity and consequently new ambiguity which may in turn be exploited by new avoidance schemes. This process could, in theory, continue indefinitely, and with it, uncertainty. If tax certainty is to be had, such cycles may need to be broken at some point.

Reflection 9:

Where tax law is drafted in such a way so that taxpayers cannot predict the outcome of transactions accurately just from that law, then reliance upon judicial interpretation in addition to the underlying words of the tax code will be necessary. This may be costly and adds to uncertainty as these may not always be uniform and could therefore be sources of uncertainty.

E. Is tax certainty meant to protect the taxpayer or the state?

Reflection 10:

If tax certainty is grounded in norms that guarantee individual rights as well as norms that establish state purposes, it will be necessary to examine the emphasis placed on each of these foundations so that they can be appropriately weighted. The impact of changes should be carefully assessed on both counts. In particular, the impact on revenue caused by changes to tax systems needs to be properly calculated as this has an impact on both the ability to guarantee and protect individual rights as well as to carry out the various other functions of the state.

Reflection 11:

Tax uncertainty confers a discretion, first upon the taxpayer, and then upon the inspecting official. Both the taxpayer and the official must each try to establish the correct tax treatment within such discretion. Given this situation, the risk to the state posed by tax uncertainty is twofold –

- taxpayers may seek their own advantage through interpretation of uncertain provisions, which may lead to tax abuse; and
- there is potential for tax officials to seek an undue advantage, either for themselves (leading to corrupt practices) or for the same state (leading to aggressive tax audits).

A reduction in tax certainty will contain both kinds of risk.

Actions Towards Tax Certainty in the EU

Tax certainty across the EU could be enhanced through a number of measures that target any or all of the following -

1. *Action Aimed at Avoidance of Disputes*

Actions need to be directed towards the actual reduction of potential disputes.

Action 1:

Enhanced (but controlled) and transparent use of binding tax rulings including Advance Pricing Agreements (APAs). Work has already been carried out within the EU Code of Conduct Group on guidelines on the conditions and rules for the issuance of tax rulings by Member States, and endorsed by ECOFIN in December 2016. Workshops could be held at EU level in order to bring a better understanding of, as well as to build capacity on, the appropriate use of such tools.

Action 2:

Improving the quality of EU tax laws, their implementation and compliance thereto. This entails that -

- the EU Commission is provided with adequate time to propose updates of such legislation, keeping in mind the volume and complexity of the current laws and the situations with which they deal;
- the frequency of amendments of such tax laws ought to be minimised;
- Member States ought to be provided with enough time to carry out the necessary impact assessment following an agreement on any tax laws, particularly in those cases where revenue may be affected. Passing and implementing laws in a hurry does not ensure clarity and certainty on the part of the Member State on what it is now legally bound by;
- EU Member States are allocated adequate time to implement such laws – again taking into consideration the relevant volume of legislation involved and the complexity with which they deal;
- training at EU level is provided to tax administrations so that EU tax laws are understood and implemented in a homogeneous manner; and
- appropriate coordinated guidance is published to aid taxpayers in complying with such tax laws.

Action 3:

Promoting a consistent and coordinated implementation and administration of the package of BEPS measures both within the EU as well at a more international level. This is particularly important given that we may end up with a situation where due to the absence of minimum standards for all BEPS actions, the level of implementation of the OECD recommendations will not be the same across the world. This may have an effect on the competitiveness of the EU vis-à-vis other economic partners worldwide. Furthermore, given the complexities of the BEPS package, capacity building for better tax administrations needs to be fostered. In particular, tax officials need to have the technical expertise in order to tackle BEPS challenges.

Action 4:

Fostering an EU culture aimed at enhancing tax administration/taxpayer trust relationships through cooperative compliance programs and the adoption of a generally cooperative approach towards taxpayers that are willing to cooperate with tax administrations. Work has already been undertaken by the Joint Transfer Pricing Group that brings together representatives of the EU Member States and the private sector to discuss and suggest solutions for transfer pricing issues. Similar groups/workshops for the discussion of subjects of interest and sharing of best practices in this area could be a good starting point in enhancing such a culture. The issue of such a culture, taking the work of the JTPF as an example could be discussed by the Council High Level Working Party on tax issues.

Action 5:

Enhance the tools in the hands of tax administrations in order to avoid unnecessary disputes through –

- providing guidelines for EU tax officials in relation to exchange of information, most notably that of a spontaneous type, so as to make such exchange easier to execute. This will have the effect of enhancing exchange of information which will aid tax administrations that receive such information in carrying out their work;
- providing clarity on what are acceptable tax practices and what are considered to be abusive tax practices in terms of features of artificial and other unacceptable tax schemes. Furthermore, it could simplify any disclosure requirements in EU Member States targeted towards any tax advisors involved in the promotion, design or implementation of such schemes, thus acting in itself as a tax certainty tool in the hands of such persons – as they will know the consequences of their actions – while at the same time providing tax administrations with invaluable information in their fight against tax evasion and avoidance.

2. *Action Aimed at Resolving Disputes*

Where disputes are not avoided, then these would need to be resolved quickly.

Action 6:

Implement appropriate mandatory dispute resolution mechanisms. The European Commission legislative proposal with regard to dispute resolution mechanisms is currently being discussed and the Maltese Presidency aims at reaching an agreement thereon by the end of June 2017. The Maltese Presidency expects full cooperation from all Member States in order that this aim is achieved.

Action 7:

Enhance the quality of tax administrations through adequate training of tax administration officials with regard to such dispute resolution mechanisms and thereby reducing inequalities between the relevant parties in tax cases.

Action 8:

Provide training to judges and other arbitrators dealing with tax cases so as to be knowledgeable of what is required of them when solving cross-border tax cases and to bring them up-to-date with decisions and tax cases both within the EU and beyond.

3. Actions in Relation to Tax Certainty within the Global Context

The EU does not exist in a vacuum and actions taken (or indeed lack of action taken) on the part of non-EU actors may constitute the source of tax uncertainty within the EU itself.

Action 9:

The implementation of international tax standards worldwide is needed in order create a level playing field across the globe. Differences in levels of implementation of such standards (in particular those developed through the BEPS Project) may act in favour of those that drag their feet and those that do not act at all. This too is a source of uncertainty. In view of this, the EU needs to take stock of the level of implementation both of these standards as well as those other recommendations that have been enacted as hard law within the EU. There is an increasing need to promote globally the steps taken by the EU in combatting tax avoidance. Through the EU Code of Conduct (Business Taxation) Group, work has continued under Malta's Presidency with a view to establish an EU list of uncooperative jurisdictions. This work needs to be carried forward, taking into consideration the work carried out by the BEPS Inclusive Framework and the Global Forum on Transparency and Exchange of Information for Tax Purposes.

Action 10:

Significant work has been carried out in the international tax area while building on taxation principles and systems that have worked for years. Any radical tampering with these principles and systems originating from outside the EU may cause severe uncertainty for EU taxpayers and tax administrations alike. Consequently, taking a consistent and coordinated approach in the face of any such radical changes that may threaten the EU's attractiveness as a place to do business is essential in order to avoid any uncertainty that may be created. The Council High Level Working Party on tax issues could examine these aspects further, which are also relevant under the external strategy for effective taxation adopted by ECOFIN on 25 May 2016.

QUESTIONS FOR MINISTERS:

1. ***Do you share the description of what 'tax certainty' is about and the challenges linked to it (reflections 1 to 11)?***
2. ***What are your views on the suggested actions to ensure a higher level of tax certainty in the EU? Do you support the actions described in the second part of the paper (actions 1 to 10)?***