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Time to stop avoiding the tax avoidance issue in Croatia? A proposal based on recent developments in the European Union

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Abstract

The paper takes a tax policy perspective in analysing the approach to tax avoidance in Croatia and expounding its existing shortcomings. It is argued that Croatia is yet to develop a coherent legislative framework suitable for curbing tax avoidance in an equitable, efficient and simple way. One instrument that has hitherto been ignored is the general anti-avoidance rule (GAAR), keystone of anti-avoidance policy in other countries. Authors propose the introduction of a specific GAAR – based on recent developments in the European Union (EU) – in Croatian tax legislation. This proposal is supported by multiple tax policy arguments. Special emphasis is placed on the requirements of legal certainty, a traditional weak spot of Croatian tax system. The proposal is put in the context of persistent quest for sustainable public finance system in times of crisis.

Keywords: tax avoidance, tax abuse, general anti-avoidance rule, GAAR, EU tax law, wholly artificial arrangements, tax policy

1 Introduction

> "The avoidance of taxes is the only intellectual pursuit that still carries any reward."
> (J.M. Keynes)[1]

Ever since its comprehensive reform in 1994 the Croatian tax system has exhibited distinct lack of coherent approach to tax avoidance. While global trends have been followed in introducing numerous targeted anti-avoidance rules (TAARs), there is a gaping absence of statutory provisions which are able to curb more complex tax avoidance schemes. Legislative instruments that fit this purpose are the so-called general anti-avoidance rules (GAARs), recently on the rise in a number of countries (Ernst & Young, 2013), largely due to growing concerns about wealthy individuals and multinational corporations (MNCs) not paying their "fair share" in the financing of public services. Tax avoidance currently ranks high on the tax policy agenda worldwide, as evidenced by the G8 and G20 meetings of 2013 and other

[1] As cited in Perrou (2006).

developments at the regional and international level (e.g. OECD's project on tax base erosion and profit shifting).

The institutions of the European Union (EU) have also taken the initiative in this area, stressing the need for a uniform anti-avoidance approach in all of the EU member states. One of its envisaged cornerstones is the "EU GAAR", as proposed by the European Commission (EC) in its non-binding recommendation of 2012. The proposal is based on the anti-avoidance approach developed by the EU judiciary in the past, which has had severe influence on member states' national legislation. Due to the lack of EU institutions' competence in tax matters, the proposal's effects are contingent on the national tax policy choices of each member state.

This paper takes on tax policy perspective in expounding that the time has come for the introduction of a GAAR – modelled after the EC's proposal – in Croatian tax system. Arguments go beyond traditional examination of GAAR's influence on efficiency and equity, paramount tax policy objectives. GAAR's potential in recovering public revenues lost to tax avoidance activities and in narrowing the tax gap via improvement of tax compliance levels is highly important in the era of fiscal consolidation. Therefore, its introduction gives a strong signal to the country creditors that the government is acting responsibly in imposing and collecting taxes, which is a prerequisite for sustainable public finance system. Given that Croatian public finances are currently undergoing the surveillance procedure by the EU institutions, this point deserves a special merit. Furthermore, it is argued that the introduction of an "EU-style GAAR" could have positive effects on legal certainty – value of particular concern for the all stakeholders in Croatia – particularly if it is accompanied with the adoption of other instruments enhancing the relationship between the tax authorities and taxpayers, e.g. advance rulings.

The paper is organised as follows. After the introduction, section two highlights the importance of tax avoidance issue for tax policy and the role of a GAAR in that context. Section three analyses the added complexity of anti-avoidance policy in member states of the EU. It also introduces the EC proposal on uniform EU GAAR and makes a brief overview of experiences with GAARs in selected crisis stricken member states (Spain, Italy and Portugal). Section four deals with anti-avoidance approach in Croatia hitherto and provides authors' proposal for the introduction of a GAAR in Croatian tax system. Fifth section contains the summary of main findings.

2 ANTI-AVOIDANCE TAX POLICY AND THE ROLE OF A GAAR

Tax policy is the art of making numerous decisions about tax structure and tax design. From a normative perspective, these decisions and their effects are typically evaluated using three criteria: equity, efficiency and administrability (Avi Yonah, 2006). In simple terms, tax policymakers must, simultaneously, strive in making the tax system as equitable (fair), economically efficient and easy-to-administer as possible. It is well established in the theory of public finance that the attainment of these goals is influenced by the reality of taxpayers' behavioural responses to taxation (Slemrod and Yithzaki, 2002). In every country there is a certain percentage of taxpayers who do not comply with their obligations prescribed in the tax statutes. Tax compliance is a complex subject that cannot be explained using only the economics-of-crime approach, i.e. considering factors such as penalty schedule and probability of detection (Alm, 2012). Other factors, like tax morale and social norms, also have an influence on the tax compliance level (Torgler and Schaltegger, 2006). While expounding the possible underlying causes of tax non-compliance goes beyond the scope of this paper, their understanding is of vital importance in the tax policy-making (Tooma, 2008)[2].

2.1 THE ELUSIVE CONCEPT OF TAX AVOIDANCE AND THE IMPORTANCE OF "LINE DRAWING"

Two general types of tax non-compliance must be distinguished: 1) tax evasion and 2) tax avoidance. This dichotomy is discernible from the legal perspective. Whereas tax evasion denotes behaviour that is illegal, i.e. contrary to the letter of the tax law, tax avoidance stands for behaviour that is legal, i.e. in accordance with the letter of the tax law, but frustrates the underlying purpose of the relevant legal rules[3]. It is far easier to detect tax evasion, within the broad spectrum of illegal actions taxpayers take with the goal of reducing their tax liability. Typical examples include income underreporting, fraudulent invoicing for VAT purposes, undervaluation of property value etc. (Alm, 2012). In contrast, characterising a behaviour as tax avoidance poses a serious challenge for the tax administration and the taxpayers themselves. This is a natural consequence of the inherent vagueness and ambiguity of the notion of tax avoidance, particularly if compared to notions such as "tax planning", "tax mitigation", or "tax minimization". As the goal of this paper is to provide a proposal to policymakers to combat tax avoidance using legislative instruments – more specifically a GAAR – it is useful to start with an attempt to elucidate the concept of tax avoidance.

One has to note first that taxpayers can make a variety of choices and decisions which directly influence their tax liability. In fact, one of the general design features of tax systems is the dependency of tax liability upon the "economic reality that has previously been regulated, classified or characterised by other branches of law (commerce or other private law)" (Ruiz Almendral, 2005). Therefore, taxpayers are generally free to choose the legal form of their economic activities, which may profoundly affect the amount of tax due. Classic examples include the choice of financing business activity with debt or equity or the option of undertaking a business activity in a corporate form. Tax planning is the umbrella term used to describe a vast array of legal activities aimed at reducing or deferring the tax liability, i.e. optimizing the tax position of a person. Tax avoidance is, in comparison, equated with those tax planning activities which are in some way considered "illegitimate" or "unacceptable" (Russo, 2007). For the sake of clarity the term tax planning (or tax mitigation) is used below only in respect of those activities that are acceptable and permissible from the tax policymakers' perspective (Atkinson, 2012).

[2] For a comprehensive survey of tax non-compliance reasons and patterns see Andreoni, Erard and Feinstein (1998).
[3] This general depiction of evasion and avoidance can be viewed as an oversimplification, particularly from the tax lawyers' standpoint. For a more nuanced discussion about the evasion/avoidance dichotomy see Uckmar (1983).

Admittedly, attempts of producing a precise definition of tax avoidance do not only represent a challenging task – it is asserted that the term "does not have a limiting and definite meaning" (Barker, 2009) – but also bear little significance for the tax policy. The focus should instead be on drawing the line between (acceptable) tax planning and (unacceptable) tax avoidance. Two aspects need to be emphasized against this backdrop: firstly, the issue of criteria that ought to be employed in the line-drawing, and secondly, the issue of institutional competence in the development of these criteria. The former usually entails the consideration of the purpose of a taxpayer's legal arrangements, which may be established on a subjective or objective basis (Zimmer, 2002). Accordingly, activities conducted with the sole or main purpose of gaining a tax benefit, contrary to the underlying intent of the applicable law, are deemed to have crossed the borderline of tax avoidance (Cooper, 2001). The latter aspect pertains to the role of the legislative and judiciary branch of government in establishing and developing anti-avoidance doctrines. While in some countries – particularly those of common law legal systems (e.g. USA) – the judiciary has taken an "activist" approach with remarkable degree of freedom and creativity in delimiting the notion of tax avoidance (Brown, 2012), in other countries – not limited only to those of civil law legal systems (e.g. Belgium, Germany, Sweden) – the role of judiciary is restricted, principally on the basis of constitutional limitations to the power of taxation (Zimmer, 2002; Vanistaendel, 1996). This is an important point for the tax policymakers, as the decision to curb tax avoidance with legislative instruments is heavily influenced by the extent and efficacy of judicial intervention in this area (Arnold, 2008).

Irrespective of the approach and instruments used for its delimitation, there are various persuasive arguments why tax avoidance needs to be recognized as an important tax policy issue. First and foremost, tax avoidance behaviour undermines the attainment of the main normative criteria used to evaluate the tax policy. Fairness is endangered because tax avoidance narrows the tax base and changes the relative shares of tax burden among taxpayers (Tax Law Review Committee, 1997), presumably – due to the inequality of avoidance opportunities – at the detriment of lower income groups (Hillman, 2009). From the standpoint of economic efficiency, tax avoidance is considered to be "socially wasteful in that it results in distorted choices made on a basis other than the marginal social cost and benefit of an economic activity" (Hyman, 2011). Furthermore, proliferation of avoidance schemes adds to the complexity of the tax legislation, as legislators try to close specific loopholes (Tax Law Review Committee, 1997), which inevitably increases the compliance and administrative costs of taxation.

Moreover, in the post-crisis era of fiscal consolidation, other negative effects of tax avoidance seem to play a more important role in the policymaking process. One direct macroeconomic effect of tax avoidance is the revenue loss for the government (Tooma, 2008), which is of special concern for the countries simultaneously faced with daunting budget deficits and public debt limits. Accordingly, strengthened anti-avoidance measures form one part of the wider tax base-broadening strategy employed for the revenue side of the fiscal consolidation (International Monetary Fund, 2013). Finally, the fact that the public outrage at tax avoidance, widely perceived as a prerogative of MNCs and wealthy individuals, has been picked up by the politicians (Freedman, 2012) cannot be underestimated. Anti-avoidance currently ranks high on the agenda of multilateral organizations – notably G20, OECD and the EU – encouraging higher degree of inter-governmental coordination necessary to restrain the avoidance schemes that exploit deficiencies of the international tax regime (Ernst & Young, 2013).

2.2 GAAR AS A POLICY TOOL IN COMBATING TAX AVOIDANCE

Legislative anti-avoidance instruments can be divided into two groups: targeted anti-avoidance rules (TAARs) and general anti-avoidance rules (GAARs). Tax systems of many countries contain both (Ernst & Young, 2013). Main difference lies in their scope of application, i.e. the type of behaviour they are targeted at. While TAARs are aimed at curbing specific tax avoidance techniques, e.g. abusive transfer pricing or debt financing, GAARs can be applied on a much broader scale, forming a sort of "catch all" anti-avoidance tool (Ostwal and Vijaraghavan, 2010). Fundamental role of a GAAR is to draw a statutory line between acceptable tax planning and unacceptable tax avoidance, by providing the tax administration and the courts a set of parameters they can take into account when deciding on the acceptability of a taxpayers' tax reduction behaviour (Brown, 2012).

Although GAARs vary in form in different countries, some common design features can be identified. Firstly, a GAAR can be applied only if a taxpayer's arrangement – a term that is usually defined very broadly (Atkinson, 2012) – results in a tax benefit (e.g. exclusion of a certain item of income from the tax base) that wouldn't arise absent of the arrangement itself (Cooper, 2001).

More importantly, application of a GAAR depends on the sought purpose of the taxpayer's arrangement. It is applied if the purpose of the arrangement was to obtain the tax benefit, thus invoking conclusion that tax avoidance is a purpose based notion (Cooper, 2001). Even though ascertaining the taxpayer's purpose, an inherently mental element of the arrangement, may appear complicated, some objective conditions (e.g. the commercial substance of the arrangement) can act as meaningful proxies, as demonstrated by many existing GAARs (Ernst & Young, 2013). Obvious problem in this regard is that "tax purpose" of an arrangement can hardly be discerned from its commercial purpose. From the taxpayers' perspective, tax benefits maximize their total net return, which provides sound commercial reason to the arrangement (Cooper, 2001). From the policymakers' perspective, as demonstrated above, it is imperative to draw the line between tax planning and tax avoidance behaviour, and taxpayer's purpose criterion seems ill-suited to achieve this goal (Atkinson, 2012). After all, a number of tax motivated activities are encouraged and supported by the policymakers, and the widespread use of tax expenditures demonstrates the importance of the so-called regulatory function of taxation (Avi Yonah, 2006). What then defines a tax motivated activity as tax avoidance, to be confronted with a GAAR, is the compatibility of its results (i.e. tax benefits obtained) with the purpose of the pertinent tax law, i.e. underlying tax policy goals (Arnold, 2008; Cooper, 2001). In other words, constitutive element of a tax avoidance scheme is the abuse of (tax) law (Ruiz Almendral, 2005), which is recognized in the GAARs of most countries (Arnold, 2008). Further difficulty in making the application of a GAAR dependent on the taxpayer's purpose lies in the relative weight assigned to other possible purposes of the taxpayer's arrangement. While there is no common standard (Atkinson, 2013), the existence of a significant non-tax purpose usually excludes the application of a GAAR (Cooper, 2001)[4].

If abovementioned conditions for its application in respect of particular taxpayer's arrangement are satisfied, GAAR gives to the tax administration the power to cancel or otherwise disallow the tax benefits obtained (Ernst & Young, 2013). Moreover, many GAARs empower the tax administration to reconstruct the arrangement on the basis of the determined economic reality and to subsequently impose tax on the basis of the reconstructed arrangement (Prebble and Prebble, 2010). While it is clear that the conferral of such broad powers to the administrative bodies poses some serious issues of its own (Cooper, 2001), this is an inevitable element of a GAAR. In any case, the policymakers should make sure that other design features of a GAAR are formed in a way that enables sufficient guidance for the administrators to apply it correctly. One of the technical solutions that serve this purpose is the setting up of a special advisory body, the so-called GAAR panel, with the task of protecting taxpayers' interests and giving advice to the tax administration (Ernst & Young, 2013).

2.3 GAAR AND THE BALANCE OF POLICY OBJECTIVES: PROBLEM OF LEGAL CERTAINTY

Integrating the standard design features described above, a GAAR is primarily a line-drawing mechanism used for tax avoidance delimitation. In addition, it enables the cancellation of tax benefits obtained via taxpayers' arrangements qualified as avoidance schemes *ex post*, upon the tax authorities' initiative and subject to judiciary review. In this fashion a GAAR can promote the attainment of tax equity and efficiency. Potential effects of a GAAR on equity and efficiency can be analysed using the economic analysis on optimal trade-off between rules and standards in tax law (Weisbach, 2002). Against this backdrop a GAAR can be characterised as an anti-avoidance standard, which – as comprehensively discussed by Weisbach (2002) – reduces the elasticity of taxable income and can enhance the efficiency of the tax system. Moreover, a consequence of an increased efficiency is that the redistribution of income becomes cheaper, leading to more progressivity, i.e. to an increase of the vertical equity of the tax system (Weisbach, 2002).

The most accentuated disadvantage of a GAAR is its supposedly negative impact on the values of the rule of law, above all on the legal certainty. Legal certainty is not only a paramount rule of law value in modern liberal democracies, but also – in a more narrow tax context – one of the main principles of taxation, endorsed already in the work of Adam Smith (Tooma, 2008). In general, legal certainty entails the guarantee of the state that the individuals ought to foresee the legal consequences of their and other social subjects' behaviour (Zolo, 2007). Thus their behaviour should be governed by law, i.e. by legal rules that meet certain criteria, and in such a way that provides adequate guidance (Atkinson, 2012). Applied to taxation, legal certainty

[4] Using the comparative approach, Arnold (2008) observes that GAARs in different countries employ different tests of taxpayers' purpose, namely "sole or dominant purpose test", "main, primary or principal purpose test" and "one of the main purposes test".

requires that the taxpayers are able to determine the tax implications of their activities *ex ante* (Atkinson, 2012).

In this context a standard criticism has been asserted that a GAAR offends the requirement of legal certainty, due to its inability to draw a bright line between tax avoidance and tax planning (Prebble and Prebble, 2010). It is argued that a GAAR cannot provide sufficient guidance to the taxpayers in arranging their affairs, while concurrently giving broad discretionary powers to the tax authorities to target numerous taxpayers' activities. As Cooper (2001) notices, however, the argument is rarely developed beyond these general assumptions. Even if one takes the argument as self-evident, there remains the question of whether some alternative solutions to the tax avoidance issue would provide more satisfactory results. One obvious alternative is the increasing reliance on TAARs, more specific and thus more certain rules. TAARs are desirable as a policy weapon against some widespread and well-known avoidance schemes – transfer pricing inevitably springs to mind – but they are not a feasible long-term solution (Cooper, 2001). Taxpayers and their advisors can circumvent a TAAR more easily and as policymakers try to plug an identified statutory loophole with yet another TAAR, a vicious circle of increasing complexity of tax law is created (Thurony, 2003), that only produces more uncertainty (Freedman, 2004). Furthermore, it is argued that the very fact that policymakers opt for the introduction of a GAAR indicates their awareness of the inherent unpredictability of taxpayers' avoidance structures (Prebble and Prebble, 2010).

Criticism of a GAAR founded on the "certainty argument" may be considered misguided from two aspects. Firstly, certainty is neither the primary aim nor a yardstick of a GAAR (Freedman, 2004). There are other policy objectives (e.g. equity, efficiency, revenue recovery) it aims to achieve and which need be used in its evaluation. In order to effectively achieve these objectives a GAAR must necessarily be constructed vaguely, at least to some extent (Prebble and Prebble, 2010). Secondly, legal certainty is not a sole virtue that must be respected by the tax policymakers. In fact, it is in direct conflict with the requirements of equity and efficiency (Zimmer, 2002). Thus the true challenge for the policymakers is to find the appropriate balance between these competing objectives, providing appropriate guidance for the taxpayers' behaviour on the one hand and the tax administration with effective tool to restrain manifold avoidance schemes on the other.

Regardless of the stated inappropriateness of using legal certainty as a benchmark for evaluating a GAAR, some authors have challenged the standard claim that the introduction of a GAAR reduces certainty. The starting point of the counterargument is Ronald Dworkin's (1978) theory about the dichotomy between rules and principles. Against this backdrop, Avery Jones (1996) and Braithwhite (2002) have advocated the use of more general principles rather than specific rules in anti-avoidance legislation. Principles are useful in determining what the rule means, i.e. in the interpretation of tax law (Avery Jones, 1996), and the combination of principles – such as a GAAR – and specific rules helps to build the integrated system of tax law, thus promoting a greater certainty (Braithwhite, 2002). Freedman (2004) has further developed the argument for using a GAAR as a general tax law principle, with the aim of providing a sensible regulatory framework in deciding which behaviour is acceptable and which is not. This argument, stemming from the legal philosophy, can be reconciled with the economic analysis of the effects of general standards and specific rules, which provides the starting basis for Weisbach's (2002) above-mentioned analysis of anti-avoidance doctrines' efficiency.

3 ANTI-AVOIDANCE POLICY IN THE EU CONTEXT

For countries that are member states of the EU policing against tax avoidance has an extra dimension (Prebble and Prebble, 2008). Namely, the requirements of the EU law, i.e. special body of law stemming from the international treaties signed by the EU member states, must be observed in the design of national anti-avoidance policy. It should first be emphasised that – due to the lack of competence conferred by the member states to the EU institutions in this area – at the moment there are no EU taxes and there is no genuine EU tax policy (Terra and Wattel, 2012). On the other hand, principle of supremacy of EU law over member states' national legislation puts significant restrictions before the national tax policymakers (Pistone, 2008).

This adds yet another layer of complexity in the anti-avoidance area. Comparative overview of EU member states' anti-avoidance legislation confirms the well-established view that the approach to tax avoidance is unique in every country (Edgar, 2008), and reveals that no general European-wide principles may be extracted from the national level (De Monès et al., 2010). In contrast, the requirements of EU law have a harmonizing effect, by setting the limitations national anti-avoidance rules need to be aligned with. Naturally, the limitations apply only if a transaction or an arrangement is carried in the EU context, i.e. is covered by the provisions of EU law. Court of Justice of the European Union (CJEU), as the only institution competent for the interpretation of EU law, has in numerous cases decided on the compatibility of the national anti-avoidance rules and EU law, resulting in the development of an implicit concept of tax avoidance applicable in the EU context (Weber, 2005).

3.1 DELIMITATION OF TAX AVOIDANCE IN THE CASE-LAW OF CJEU

CJEU's reasoning in "tax avoidance cases" is derived from the prohibition of abuse of law, a newly recognized general principle of EU law. Put simply, taxpayers cannot rely on the provisions of EU law if their behaviour constitutes the abuse of pertinent law. As CJEU has very early recognized the acceptability of tax planning activities which entail the use of EU internal market benefits (Schön, 2008), the line had to be drawn between abusive practices, i.e. tax avoidance behaviour and legitimate tax planning. Two landmark decisions of the CJEU serve this purpose.

Decision in the *Halifax* case (CJEU, 2006a) clarified that two elements constitute an abusive behaviour. Firstly, the transactions gave rise to tax advantage contrary to the purpose of pertinent rules of EU law (the "objective element"). Secondly, the essential aim of the transactions was to obtain a tax advantage (the "subjective element"). Since *Halifax* case was about the abuse of provisions of EU VAT Directive, the question lingered whether the same or similar test could be applied in the tax areas largely unharmonised on the EU level, such as direct taxes. *Cadbury Schweppes* decision (CJEU 2006b) plays a key role in this regard. In that case the compatibility of national anti-avoidance rules (namely, CFC rules) with the EU freedom of establishment was tested. CJEU clarified that market freedoms can be restricted using the tax avoidance argument only in cases of “wholly artificial arrangements”. CJEU has planted the seed for the development of this influential doctrine as early as 1998 in its *ICI* decision (Schön, 2013). After *Cadbury Schweppes* it has become clear that a two-pronged test needs to be used in defining wholly artificial arrangements (Lampreave, 2012). The test is very similar to that applied in *Halifax*. Subjective prong consists of the analysis of the taxpayer's purpose, with special emphasis on the search for valid business purpose of the arrangement, other than acquiring of the tax benefit. Objective prong involves the analysis of the economic reality of the arrangement, where the lack of economic substance exposes the artificiality of the arrangement.

Subsequent case law of the CJEU seems to confirm the view - subject to some ambiguities - that a single anti-abuse theory underlies decisions in *Halifax* and *Cadbury Schweppes* cases (Jimenez, 2012). From the tax policy perspective, it is essential to note that CJEU's approach in tax avoidance cases shares features remarkably similar to those found in statutory GAARs. More specifically, the decisive criteria CJEU uses in delimiting the notion of tax avoidance are: 1) the purpose of the EU law relied upon by the economic operator (objective element), 2) the intent of the economic operator of obtaining tax benefits via pertinent EU law abuse (subjective element) and 3) the relative weight assigned to the “tax saving intent” and to other, commercial (business) aims of the transaction(s) concerned. Hence it is argued that the CJEU has developed a fully-fledged GAAR applicable in the EU context (Sinfield, 2011). While hitherto the compatibility of member states' GAARs with the "EU GAAR" hasn't been tested before the CJEU, there is an abundant case law concerning various national TAARs (Ruiz Almendral, 2013), confirming the view that national anti-avoidance rules need to follow the boundaries laid down by the EU law. This "negative integration" of member states' tax systems[5] is problematic from the tax policy standpoint, since CJEU is not the institution whose task is to model tax policy (Dahlberg, 2007).

3.2 MOVING TOWARDS UNIFORM STATUTORY GAAR IN THE EU: COMMISSION'S RECOMMENDATION ON AGGRESSIVE TAX PLANNING

In December 2012 European Commission (EC) issued the Recommendation on Aggressive Tax Planning, a non-binding act addressed to the EU member states, sketching the outline of the harmonized EU approach towards the most aggressive types of tax avoidance behaviour. One of its most ambitious points is the proposal for the adoption of a uniform GAAR in all member states, to be applied equally in purely domestic, intra-EU and third-country situations (Lyons, 2013). The wording of the proposed EU GAAR is based on the anti-avoidance case law of the

[5] About the dichotomy between positive and negative integration of EU member states' tax systems see Terra and Wattel, 2012, pp. 36-39.

CJEU. The "wholly artificial arrangements" doctrine, as delineated in *Cadbury Schweppes*, is of particular influence, as the application of the proposed GAAR is restricted only to artificial arrangements – i.e. arrangements lacking commercial substance – or artificial series of arrangements set up with the essential purpose of tax avoidance and leading to tax benefit (EC, 2012). The Recommendation also contains an exemplary, non-exhaustive list of arrangements lacking commercial substance, and provides definitions of other terms used in the wording of the proposed GAAR; namely, definitions of "an arrangement", "essential purpose of tax avoidance" and "tax benefit" are contained. When the conditions for the application of the proposed GAAR are met, tax authorities are to treat artificial arrangements by reference to their economic substance, i.e. they are granted the power of re-characterisation.

It is apparent that the EC is well aware of the shortages of negative integration approach in the tax avoidance area. Legal certainty and competitiveness at the internal market can be truly enhanced only via positive integration, i.e. via codification of harmonized rules at the EU level (Sinfield, 2011). In this context, lack of competence in regulating tax matters by the EU institutions poses a familiar obstacle. On the other hand, "soft law" mechanisms, such as the abovementioned EC Recommendation, could have a higher chance of success in the changed economic environment. Latest economic crisis and ensuing EU sovereign debt crisis has demonstrated that the flaws of member states' national tax systems may become an EU-wide problem. Member states seeking financial assistance by the EU institutions have been faced with obligations relating to the improvement of tax potential through higher compliance levels, including the more serious approach to tax evasion and tax avoidance (Lyons, 2013). This is best evidenced by the tax reforms in Greece – a country that epitomises the Eurozone crisis – of 2013. Among other measures aimed at combating tax non-compliance, a GAAR has been introduced in the Greek tax system for the first time (Stathis, 2014). The wording of the new rule – effective as of January 1st 2014 – is overwhelmingly reminiscent of the uniform EU GAAR proposed by the EC, with the existence of artificial arrangements being the main condition for its application.

3.3 GAARS IN SELECTED CRISIS-STRICKEN EU MEMBER STATES

A number of EU member states have opted for the introduction of a GAAR as an instrument to curb tax avoidance some time before the full development of an EU GAAR in the CJEU's case law. Some of these countries have since been deeply affected by the economic crisis, entailing the necessity of tax policy reconsiderations. The depiction of different GAARs introduced in Spain, Italy and Portugal can provide useful insights for tax policymakers in Croatia, a new EU member state with similar legal tradition and comparable levels of factors influencing tax compliance, e.g. tax morale (McGee and Tyler, 2006). All three countries in consideration have introduced a GAAR in their tax system long before the beginning of the crisis in 2008, with the aim of achieving equitable allocation of tax burden and increasing the collection of tax revenues. While Italy has developed a strong judicial GAAR accompanied by statutory TAARs, Spain and Portugal have introduced a statutory GAAR. A strong influence of the EU law – and

CJEU's anti-avoidance approach in particular – is notable in all three countries. Even in areas not harmonised by the EU legislation – such as direct taxation – many features have been subject to judicial assessment and therefore indirectly harmonized (Ruiz Almendral, 2005).

Spanish tax system contains a GAAR, applicable in cases of conflicts in the application of tax rules, and TAARs, intended to prevent specific transactions or application of different tax treatment sought by the parties (Clifford Chance, 2013). As the previous provision was hardly ever used during forty years, a new GAAR was enacted by the General Tax Code of 2003 – replacing previous GAARs which have been in use since 1963 – with the aim to revitalise its use by the tax administration and the courts by defining tax avoidance in a clearer manner (Ruiz Almendral, 2005). A "conflict in the application of tax rules" – term that actually denotes tax avoidance (Soler Roch, 2004) – arises where: 1) the taxpayer avoids the taxable event or reduces the taxable basis or tax payable through transaction which is highly artificial or not typical for achieving the result obtained or 2) the transaction achieves material legal or economic effects or benefits that differ from those that would have resulted from a non-artificial transaction.

The application of a GAAR requires the Spanish tax authorities to make evident that an abuse of law has occurred. This is achieved via taxpayer's behaviour comparison with the intention of verifying whether the businesses or transactions are genuine or artificial. Spanish General Tax Code sets out an administrative requirement for the GAAR's application. A special report on tax abuse – which is binding on the tax auditor (De Monès et al., 2010) – needs to be issued by the special advisory committee comprising of two representatives from the central government and two representatives of the acting tax administration. The taxpayer is given 15 days to present a case, and the committee then issues its findings (Tooma, 2008). The Spanish tax authorities and courts apply tax law in broad terms, instead of specifically applying GAAR. In cases of applying provisions on GAAR, tax authorities are required to produce a report justifying the application of GAAR to the transaction. The consequence of application of GAAR to a conflict in the application of tax regulations is elimination of tax benefits and charging interest for late payment. In case of shams, penalties may apply too. From the tax policy perspective, tendencies in Spain favour the reliance on an increased number of TAARs rather than a broad use of the GAAR (Clifford Chance, 2013).

There are two main anti-avoidance tools in Italian legislation. Alongside various TAARs, a rule introduced in 1997 (Article 37bis of the Decree No. 600/1973) allows the tax authorities to disregard transactions lacking a valid economic purpose, aimed at circumventing obligations or providing unduly tax reductions (De Monès et al., 2010). This rule is widely applied, but in fact is not a GAAR since it is limited to the specific list of transactions. Hence, it can be concluded that it falls between a GAAR and a TAAR. Through strict implementation of the principle of legality and through broadening the scope of rule contained in Art. 37bis, Italian case law has evolved as if it contained a GAAR. Since 2005 Italian courts have taken a flexible anti-avoidance approach, allowing the tax authorities to declare tax benefits derived from certain transactions ineffective. The Italian Supreme Court played the crucial role, asserting that the absence of explicit anti-avoidance provisions does not prevent tax authorities or the courts to declare taxpayers' transactions void and collect taxes, based upon the application of civil law doctrines such as the doctrine of abuse of law (Cordeiro Guerra and Mastellone, 2009). This new development – amounting to the creation of a GAAR by the judiciary – is defended by the Supreme Court on the grounds of ability to pay principle, enshrined in Article 53 of the Italian Constitution (Garbarino, 2012), but is also influenced by the anti-abuse doctrine of the CJEU (Soler Roch, 2012).

Consequently, Italian tax authorities are now more open to applying the rule contained in Art. 37-bis or the more general abuse of law principle in their efforts to curb tax avoidance schemes (Ernst & Young, 2013). A transaction is considered abusive if it is aimed at avoiding taxes, if any tax benefit or saving is a dominant reason for carrying it out or if there are no clear economic reasons for entering it. In practice, GAAR is mostly used in cases of misapplication of tax provisions in transactions which are not fraudulent, but aimed at obtaining a tax benefit. The burden of proof falls on the Italian tax authorities, i.e. they have to demonstrate the tax advantage derived from the transaction and the elements proving that it is abusive. In contrast, taxpayers may provide clear and significant business reasons to justify the transaction. In case of re-characterization of an abusive transaction by the tax authorities, tax rates that would have been applied had the abusive transaction not been entered into will be applied. According to the Supreme Court, penalties or criminal sanctions are not applicable to transactions deemed as abusive (Clifford Chance, 2013).

The Portuguese GAAR sets out that any transaction implemented by artificial or fraudulent means or by abusing legal forms and wholly or mainly aimed at reducing, avoiding or postponing taxes that would be payable as result of transactions with the same economic purpose or to obtain tax advantages that would not be achieved without the use of these means, is ineffective for tax purposes. Taxation should proceed in accordance with the rules that would have applied in the absence thereof. The tax advantages intended to be achieved by this transaction may not arise (Santiago, Salema and Carvalho Nunes, 2011). This rule was introduced in the Portuguese legal system in 1999, under influence of other European countries, along with the introduction of TAARs, e.g. on transfer pricing and thin capitalization. Although the GAAR had not been applied for over a decade, a number of cases where it was applied recently considerably increased. The aim of these rules was to guarantee compliance with the principles of equality in financing public expenditures. The GAAR has proven to be difficult to apply as the burden of proof falls on the tax authorities, thus weakening the preventative character of the rule. The tax authorities have instead mostly applied TAARs, where the burden of proof falls upon the taxpayer (Fernandes Ferreira, Respício Gonçalves, Bordalo e Sá, 2011).

4 ANTI-AVOIDANCE POLICY IN CROATIA: A PROPOSAL

During the transition era of the 1990s a new tax system suitable for the market-oriented economy had to be created in Croatia (Arbutina et al., 2014). Therefore, it is not surprising that tax evasion was perceived as the more important tax policy issue than tax avoidance. Over the years various interventions in the tax statutes have been made with the aim of curbing some recognised tax avoidance techniques. The importance of legislative instruments in this area should be emphasized, as Croatia has both a civil law legal system with strong adherence to the constitutional principle of legality and the long tradition of literal interpretation of the law by the courts (Aviani and Đerđa 2012). Against this backdrop, dynamics of changes to the anti-avoidance legislative framework reveal that Croatia lacks a coherent anti-avoidance policy (Prebble, 2005). In comparison to other countries, Croatian approach to this important tax policy issue is both underdeveloped and fragmented.

4.1 EXISTING ANTI-AVOIDANCE LEGISLATIVE FRAMEWORK IN CROATIA

The obligation to pay taxes in Croatia, similarly to other countries, stems from the constitutional principle of ability to pay. Namely, the Art. 51 of the Constitution lays down that every person should participate in the defrayment of public expenses in accordance with his or her economic capacity. The Constitution further stipulates that the tax system should be based upon the principles of equality and equity, establishing the paramount objectives of Croatian tax policy. These constitutional principles are reflected in manifold statutory provisions. For example, Art. 9 of the General Tax Act (GTA) obliges the parties of the tax relationship to act in good faith, i.e. to conduct themselves conscientiously and fairly in accordance with the law. Tax avoidance behaviour undermines the attainment of both dimensions of equity. Horizontal equity is endangered since the share of tax burden borne by two taxpayers with equal economic faculty differs depending on their usage of tax planning schemes. Vertical equity is endangered since tax avoidance schemes – particularly the most notorious corporate tax shelters revolving around international tax arbitrage – are largely a privilege of the high income earners, lowering the effective tax system's progressivity. Consequently, anti-avoidance legislative instruments in Croatia – including a GAAR – can be justified by this constitutional principle, similarly to the approach taken by the judiciary in Italy (see Section 3.3.).

Croatian tax legislation does not contain a GAAR (Rogić Lugarić and Bogovac, 2012). However, certain provisions which follow the same underlying objectives as a GAAR – even if lacking its breadth – can be found. Of special importance is the provision found in Art. 10(1) GTA, effectively codifying the substance-over-form principle in the process of determining tax facts. This provision – labelled as "economic approach principle"– sets out that "(T)ax facts shall be determined according to their economic essence". Additionally, Art 10(2) GTA provides that "(I)f the revenue, income, profit or other assessable benefit was acquired without a legal basis, the tax authority shall determine the tax liability in accordance with a special law regulating certain types of taxes". The implementation of this principle allows the tax administration to tax profit incurred even by a criminal act, with the basic idea to tax the underlying economic substance, while the general character of a legal action that led to the profit is irrelevant for tax law (Rogić Lugarić and Bogovac, 2012). Hence, some consider it to be a potentially powerful anti-avoidance rule, comparable to a GAAR (KPMG, 2013). Even though the intent of these provisions corresponds to the one of a GAAR, they are extremely vague and do not provide further instructions for application to the tax authorities. Therefore, it is not surprising that – while the provisions on economic approach principle have been in force since 2001 – their anti-avoidance potential has hitherto not been recognized by the tax authorities.

By similar token, an anti-avoidance rule aimed at preventing the abuse of legal form, i.e. codification of the sham doctrine, is found in Art. 11 GTA: “If a sham transaction conceals another legal transaction, the basis of the assessment of tax liability shall be that concealed legal transaction." On the basis of this provision tax authorities can requalify the transaction and neglect the form contracting parties have chosen for the transaction. The transaction will therefore be considered to have been concluded in the legal form which corresponds with the real intention of contracting parties (Šimović et al, 2010). While it is contended that this provision is seldom applied by the tax authorities, some authors argue that it should gain more importance in the future, especially with regards to transactions that involve real estate purchases via business shares sales (Kapetanović, 2010; Prebble and Prebble, 2008).

Additionally, various TAARs can be found in Croatian tax legislation, mostly related to corporate income taxation. For instance, a rule targeted at thin capitalization as well as a rule setting the higher rate of withholding tax on certain payments made to residents of expressly listed tax haven countries are contained in the Corporate Income Tax Act (CITA). From the tax policy perspective it is very interesting that some of the most controversial changes of tax legislation of late – including the new TAARs – seemingly reflected the awareness that tax avoidance needs to be restrained. Yet, no one single theory underlying the anti-avoidance approach in tax legislation can be identified.

Abuse of law doctrine – deeply rooted in Croatian civil law – was used to justify the GTA amendments of 2012, laying down the special procedure for “piercing the corporate veil” in tax matters (Žunić Kovačević and Gadžo, 2013). The amendments provoked intense reactions of the business community as shareholders, board members and executive directors of a company – as well as persons associated with them – can be declared to be liable for company's tax debt by the tax authorities, under condition that the abuse of rights or power leading to company’s inability to pay the tax debt is established. On the other hand, one distinctive TAAR was included in the CITA amendments of 2012 that introduced a tax benefit for reinvestment of company profits. Namely, the corporate income tax base can be reduced for the amount of company's capital increase made for investment and development purposes. From the outset, policymakers have recognized the tax avoidance potential of this benefit (Jozipović, 2013) and introduced a TAAR, which stipulates that the entitlement to reduce the corporate income tax will not be granted if it is obvious that the intention of the company’s capital increase was tax evasion or tax avoidance. Examination of taxpayer's purpose as a condition for the application of anti-avoidance rule is what makes this specific TAAR similar to GAARs found in other tax systems.

The wording of the abovementioned TAAR is to some extent comparable to that of the TAARs applicable in the context of three EU direct tax directives. Provisions of Merger Directive (European Council, 1990a, hereinafter: MD), Parent-Subsidiary Directive (European Council, 1990b, hereinafter: PSD) and Interest-Royalties Directive (European Council, 2003, hereinafter: IRD) have been implemented in Croatian legislation – mostly in CITA and in the Ordinance on Corporate Income Taxation – during the process of accession to the EU. It appears that Croatian legislator opted for uniform anti-avoidance approach in the tax directives context, even if the wording of different TAARs is not identical. Consequently, the benefits of the MD, PSD and IRD are to be denied if the principal purpose or one of the principal purposes of the pertinent transaction/arrangement is tax evasion or tax avoidance. It can be concluded that the harmonization of Croatian tax law with the EU law requirements brought about some important changes to the approach in design of anti-avoidance legislation. More specifically, the taxpayer's purpose as the subjective element of the transaction – previously not acknowledged in the delimitation of tax avoidance – is now a recognized constitutive element of tax avoidance, albeit in a limited number of TAARs. The indubitable influence of the EU law on the Croatian anti-avoidance law provides a point of departure for future policy choices in this area.

4.2 PROPOSAL FOR THE INTRODUCTION OF THE EU GAAR IN CROATIA: PRINCIPLE OF LEGAL CERTAINTY AS A STARTING POINT

The preceding overview of Croatian anti-avoidance legislation may lead to conclusion that the introduction of a GAAR was considered to be unnecessary by the policymakers and the policy choice was to rely on TAARs as key anti-avoidance tools. In our view this would be misleading. A more detailed analysis of legislative dynamics in this area reveals that Croatian tax policymakers do not have a coherent anti-avoidance approach. What is particularly worrying is the absence of uniform criteria used in the all-important line-drawing process, i.e. in delimiting tax avoidance notion (see section 2.2.). As demonstrated above, in some cases – e.g. when applying the GTA provisions on sham transactions and in "piercing the corporate veil" cases – the abuse of law or abuse of rights by the taxpayer is the defining element of tax avoidance. Here the purpose of the taxpayer's transaction/arrangement – be it tax saving or any other commercially justified purpose – is rendered unimportant. In other cases – e.g. when applying TAAR concerned with the tax benefit for reinvested profits or TAARs implementing the provisions of EU direct tax directives – taxpayer's purpose is the essential element.

As described above (see section 3.1.) the CJEU regards both the objective criteria, i.e. abuse of pertinent law, and the subjective criteria, i.e. taxpayer's purpose, as constitutive elements of tax avoidance. Therefore, the reconciliation of differing criteria in delimiting tax avoidance in Croatia is possible if viewed in the light of EU law requirements. In fact, Croatian tax authorities and courts are already obliged to adhere to the CJEU's notion of tax avoidance whenever applying national anti-avoidance rules on transactions/arrangements that are covered by the provisions of EU law. More leeway is allowed only with regards to strictly national and third-country (non-EU member states) situations.

That is where the shortcomings of delineating tax avoidance notion in a clear and consistent way could have serious consequences. For example, it is very unclear how the Croatian tax authorities will determine tax avoidance intent with regards to the tax benefit for reinvested profits, as no further instructions for the application of this TAAR were given in tax legislation or in the tax authorities' non-binding opinions. Furthermore, the role of abuse of law principle in future developments of anti-avoidance legislation remains uncertain. Will the policymakers rely on this principle in introducing new anti-avoidance rules, following the pattern of the provisions on piercing the corporate veil in tax matters? In this context the utter absence of debate between the stakeholders – including the Ministry of Finance as the key player in the development of Croatian tax policy (Arbutina et al., 2014) – about the desired anti-avoidance approach, e.g. about the GAAR – TAARs dilemma, also needs to be stressed. It follows that the taxpayers in Croatia are not able to determine the tax implications of their activities in advance, i.e. that the requirements of legal certainty have not been met (see section 2.3.). This is confirmed by the findings of one recent study, stressing that the defects of legal certainty in tax matters are perceived in the Croatian business community as the main tax obstacle to inbound foreign investments (Rogić Lugarić and Bogovac, 2012).

In our view Croatian tax system provides a perfect example how the introduction of a GAAR can actually enhance legal certainty, contrary to the standard argument that a GAAR defeats this rule of law value. Frequent changes in the anti-avoidance legislation – primarily the introduction of the new TAARs – mirror the general problem of Croatian tax system ever since its comprehensive reform in 1994: instability of legislative framework (Bejaković, 2009; Žunić Kovačević, 2012). As the line between acceptable tax planning and unacceptable tax avoidance has not been properly drawn – nor in the tax statutes nor by the judiciary – anti-avoidance tax policy in Croatia has hitherto worked to the detriment of legal certainty. A GAAR – even if inherently vague to some extent – can draw this missing line in a meaningful way, providing the appropriate guidelines to the tax authorities and courts, which traditionally rely on the literal interpretation of the law, overlooking the underlying policy objectives. An analysis of the implications of the reformed GAAR in Spain – country with comparable legal tradition and the attitude of courts to tax law interpretation – is in line with these conclusions (Ruiz Almendral, 2005).

It must be noted that the design features of a GAAR are decisive for the evaluation of its potential influence on legal certainty. Against this backdrop, we share the view that Croatian GAAR should be modelled after the proposal made by the European Commission in 2012 (see section 3.2.). As examined above, some anti-avoidance provisions that are already in place in Croatian tax system share certain common features with the proposed EU GAAR. But the main advantage of introducing the EU GAAR – observed through the lens of legal certainty – is that that its wording – based upon the EU law as interpreted by the CJEU – provides very detailed guidelines on the delimitation of tax avoidance behaviour to the tax authorities, courts and the taxpayers themselves. Likewise, CJEU can be relied upon to clarify the inevitable ambiguities that will appear in the future practice (Clifford Chance, 2013). Moreover, legal certainty could be enhanced via some instruments accompanying a GAAR. Establishment of a specialized GAAR panel (for Spanish model see section 3.3.), introduction of advance rulings issued by the tax authorities on the taxpayer's request (Žunić Kovačević, 2013) and a broader use of the tax authorities' public opinions clarifying the practices in the GAAR application could serve this purpose.

The EU GAAR in Croatian tax system should be underpinned by TAARs - some already in force - addressing some distinctive tax avoidance techniques, but reflecting the same general concept of tax avoidance as defined by a GAAR. Whenever a TAAR is applicable, the tax authorities should not have the option of invoking a GAAR – in line with the *lex specialis* doctrine – thus enhancing legal certainty. Usage of a GAAR as a last resort is also confirmed in comparative surveys (Clifford Chance, 2013). Another legislative instrument worth considering in the future development of coherent anti-avoidance policy in Croatia is the introduction of rules requiring that taxpayers disclose the usage of specific tax shelters to the tax authorities, which are proving to be efficacious in the USA (Kaye, 2012).

4.3 PROSPECTS OF EU GAAR IN THE ATTAINMENT OF OTHER POLICY OBJECTIVES

It has been argued above that anti-avoidance tax policy is about finding the right balance in attaining multiple objectives (see section 2.3.). Hence, legal certainty is not the only objective policymakers ought to be concerned with when deciding on the introduction of a GAAR. The principle of tax equity – as stipulated by the Constitution – marks the paramount objective of Croatian tax policy. As tax avoidance behaviour undermines the attainment of equity – as well as inflicting economically wasteful social costs – developing the coherent anti-avoidance approach needs to rank high on the Croatian tax policymakers' agenda.

While the above analysis points out the inadequacies of existing anti-avoidance legislative framework, there is a lack of empirical evidence on the actual extent of tax avoidance in Croatia, which could provide impetus for reforms. On the other hand, some conclusions can be inferred by analysing the factors commonly associated with tax evasion and avoidance (International Tax Compact, 2010). It seems that most of these factors – e.g. low tax morale, large informal sector of economy, high corruption, frequent changes of tax legislation etc. – are present in Croatia. Moreover, the nature and the extent of tax expenditures in Croatian tax system – necessarily leading to the avoidance opportunities (Tyson, 2014) – opens wide scope for the abusive taxpayers' behaviour. Admittedly, this has been recognized by the policymakers at least to some extent, as shown by some of the more recent changes in the tax legislation. For example, the introduction of the provisions on tax benefit provided for the reinvestment of corporate profits was accompanied by a special anti-avoidance rule. Moreover, other measures aimed at tax non-compliance were also introduced, e.g. establishment of the special tax administration unit focusing on large taxpayers, relaxation of tax secrecy provisions allowing the publication of tax debtors' blacklists etc. While this clearly reflects tax gap narrowing policy, it was most likely motivated by the objectives much more mundane than the objectives of tax equity and tax efficiency.

More specifically, tax reforms in Croatia ever since the outburst of latest economic crisis – which is showing no signs of waning – were driven by the ensuing pressures of fiscal consolidation (Arbutina et al., 2014). Very soon after its accession to the EU, Croatia – failing to meet the fiscal targets set out in the EU legislation – entered the excessive deficit procedure (EDP), with its public finances placed under monitoring by the EU institutions. Whereas there seems to be an agreement in the tax community that there is no space for the further increase of the overall tax burden – especially considering the heavy tax burden on consumption and labour – the potential fiscal effects of the policy aimed at enhancing tax compliance have been largely overlooked. Experiences of other crisis-stricken EU member states (e.g. Greece, Ireland, Portugal, Cyprus) demonstrate that one of the conditions for the EU financial assistance is the development of a strategic approach in fixing structural deficiencies of the national tax system, including the approach to tax compliance (Lyons, 2013). In this context, improvement of anti-avoidance legislation can send a strong signal both to the EU institutions and to the financial markets that Croatia is dedicated to follow fiscally responsible tax gap narrowing policy.

All of the abovementioned policy objectives could be promoted by the introduction of the EU GAAR in Croatian tax legislation, similarly to the recent legislative changes in Greece (see section 3.2.). Even if this specific GAAR proposed by the EC is criticised by some authors for its lack of flexibility in combating tax avoidance (Faulhaber, 2010), in our view it would still provide solid foundation for curbing those types of taxpayers' activities that are blatantly abusive. Since the tax authorities would be provided with a clear set of guidelines – aligned with the CJEU's case law – on the GAAR's application, there would be no justification to shy away from invoking this rule in practice and to rely solely on its deterrent effect. Tax authorities' power to tax pertinent transactions/arrangements with regards to their economic substance clearly promotes the attainment of tax equity and tax efficiency; it safeguards taxation in accordance with the taxpayers' activities which are economically rational, disregarding the complex strokes of an accountant's or a tax lawyer's pen. Additionally, the development of a coherent anti-avoidance framework – with the GAAR as its keystone – can have significant revenue effects, mostly due to its positive influence on the overall tax compliance.

One final policy objective that can be attained by the introduction of EU GAAR in Croatia is its potential in improving tax competitiveness. Its introduction would entail that the same anti-avoidance approach is to be followed by the Croatian tax authorities and courts irrespective of the context – i.e. national, EU or third country context – in which an arrangement is undertaken. In this respect Croatia would have simpler and more attractive anti-avoidance framework if compared to other EU member states countries that have developed complex anti-avoidance strategies over the years (for an Italian example see chapter 3.3.). This is a point that deserves special merit in times when countries are increasingly relying on their tax systems' features to attract foreign inbound investments.

5 CONCLUSION

The approach to tax avoidance is currently high at the tax policy agenda throughout the world and is probably here to stay. At least until satisfactory solutions are found for some of the most notorious avoidance schemes that exploit the shortcomings of international tax rules and the lack of cooperation between different tax authorities. In the meantime many countries have opted for the introduction of various legislative instruments with the aim of curbing tax avoidance and protecting their tax base from further erosion. Global trends point out that GAARs are perceived as keystones of anti-avoidance legislation, particularly in countries where tax authorities and courts traditionally refrain from taking the proactive approach in combating taxpayers' abusive behaviour. While it must be conceded that GAAR is not a "magic bullet" for a multifaceted phenomenon like tax avoidance, the necessity for legislative measures aimed at curtailing it cannot be negated (Zimmer, 2002; Tax Law Review Committee, 1997). Main function of a GAAR is that it draws a line between acceptable tax planning and unacceptable tax avoidance, thus having a potential of achieving multiple tax policy objectives.

Analysis presented in this paper displays that Croatia lacks genuine and coherent anti-avoidance policy. Hitherto the policymakers have not recognized the potential of a GAAR in attaining multiple desired tax policy objectives. We share the view that the time is right for the introduction of a GAAR modelled after the EU GAAR endorsed by the European Commission. Several policy arguments are provided in support of this view. Firstly, promoting legal certainty, along with the constitutional principle of tax equity, should be one of the main objectives of Croatian tax policy in the time to come, Introduction of the EU GAAR in Croatian tax legislation could improve legal certainty, primarily since copious case law of the CJEU can provide detailed guidelines on the application of a GAAR to all parties of the tax relationship. Additionally, other policy objectives – i.e. tax equity, tax efficiency, revenue collection, tax competitiveness – could also be attained with the suggested legislative changes. A point that deserves special merit in the light of the enduring macroeconomic problems in Croatia is the significance of a coherent anti-avoidance framework on the tax gap narrowing policy and hence for the construction of a sustainable public finance system. The experiences of other crisis-stricken EU member states point out that the adoption of a GAAR (or its strengthening) provides a standard policy choice in this context.

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