



# Analysis: EU Action plan to strengthen the fight against tax fraud and tax evasion

Compiled by Eurodad with input from CCFD-Terre Solidaire, SOMO, TJN Europe and Alliance Sud  
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## Overall comments

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- The action plan provides several opportunities, including specific measures on an EU definition of tax havens, measures related to automatic information exchange, closer cooperation to fight tax evasion and elusion (aggressive tax planning). It also includes several other measures such as an EU taxpayers charter and the revision of the Parent-Subsidiary Directive which could open up new opportunities to promote our asks.
- The **Action Plan fails to mention CCCTB** as a tool to fight against aggressive tax planning. For more information on how CCCTB works, as well as on the limitations of the current proposal and possible amendments, see the following report: [http://www.taxjustice.net/cms/upload/pdf/Towards\\_Unitary\\_Taxation\\_1-1.pdf](http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf)
- The **Action Plan fails to mention country-by-country reporting** by multinational companies as a key transparency initiative to address aggressive tax planning. The review of the Transparency Obligation Directive in 3-5 years (depending on the current negotiations of the review clause) would be an opportunity to include these information requirements in the directive.
- In relation to **Anti-Money Laundering rules** good points include the suggestion that tax crimes might be made a predicate offence of money laundering, the calls for improved due diligence by relevant professionals and for greater international cooperation between tax authorities and other law enforcement. It is encouraging that the Action Plan calls for greater transparency around beneficial ownership but it is unclear if this will entail concrete measures such as requiring government registries to record and verify owners' identities. It is interesting that it mentions a possible second directive to tackle money laundering in 2013, this would in fact be a measure to criminalise money laundering at the EU rather than member state level.

- The Action Plan does not address the impact of the FATCA directive in EU countries. Luxembourg, for instance, is currently in negotiation with the US. This could open the door for similar provisions within the EU. The [Finance Minister from Luxembourg has publicly acknowledged](#) that such precedent would make it difficult to deny EU countries a similar treatment.

## Comments on the EC Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters

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### Scope

The recommendation applies to jurisdictions which are not Members of the EU (third countries). This excludes all 27 Member States and will not affect countries such as Austria, the Netherlands or Belgium. Nonetheless, it should include European microstates such as Andorra, Liechtenstein, Monaco, San Marino and Vatican City.

For similar reasons, the French overseas territories (Mayotte, New Caledonia, French Polynesia, Saint Pierre and Miquelon and Wallis and Futuna), the Netherlands' overseas territories ( Aruba, Curacao, Sint Maarten, Bonaire, Sint Eustatius and Saba) and the British overseas territories (Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn Islands, Saint Helena, Ascension and Tristan da Cunha, South Georgia and the South Sandwich Islands, and Turks and Caicos Islands) should be considered as third countries.

The situation of the British Crown Dependencies is unclear. The Channel Islands (Alderney, Guernsey, Jersey, Sark, Herm and Les Minquies) and the Isle of Man, are not officially part of the EU and their relationship with the EU is regulated under Protocol 3



of the UK's Treaty of Accession to the European Community. In the interpretation of "third country equivalence" of the Anti-Money Laundering Directive, these territories are considered as equivalent to EU Member States. Other territories such as Campione d'Italia and Livigno are in a similar situation.

Many of these territories are frequently listed as tax havens. It is therefore important that DG TAXUD clarifies exactly which territories and jurisdictions will be considered as equivalent to EU Member States and which ones will be considered as "third countries" for the purpose of the recommendation.

### **Minimum standards of good governance**

The standards are based on two existing processes: the OECD Global Forum process and the EU Code of Conduct for Business Taxation. Sensibly the two elements are non-cumulative (i.e., countries are deemed tax havens if they either engage in harmful tax practices or avoid an effective exchange of information; they do not have to fulfil both elements).

**The OECD Global Forum criteria** are included in an annex of the recommendation, but it does not contain the original OECD detailed instructions on how these criteria should be applied. It is not clear why the Commission has dropped these instructions (space?). More importantly, it is not clear whether the EU will base any actions on the outcomes of the Global Forum or apply the Global Forum criteria independently.

The Global Forum itself is a highly politicised process and, while the criteria might be valid to tackle some of the problems, the implementation of the standards raises some important concerns. TJN has shown in the report "[Creeping Futility](#)" that the outcomes of the peer review processes are severely politically biased. These findings are still valid. There are no public clear-cut criteria that would allow objective identification of those jurisdictions which would be deemed non-compliant. Countries which were rated as having an element "not in place" such as the United Kingdom or Monaco were allowed to move to Phase 2, while those with two elements not in place were denied to proceed. It is far from clear why anything less than all elements being fully in place should be enough for being assessed as compliant.

G20 nations, in addition to OECD members, appear also to be treated preferentially. More details on further

severe problems of the process and decision-making at the Global Forum have been identified in TJN's 'Creeping Futility' report from March 2012, particularly on pages 6-11.

In addition, the listing process has resulted in - temporary- absolution of some of the most troublesome jurisdictions. *"The blacklist is empty. The grey list consists of three jurisdictions - Nauru, Niue and Guatemala. On this measure, everyone else is clean! Including some of the world's dirtiest secrecy jurisdictions, such as Panama, the British Virgin Islands and the UAE (Dubai)."*

Apart from the OECD grey list from 2009 which contains only 3 territories, The G20 lists all the jurisdictions not allowed to go to phase II The latest available list contains the following countries Botswana, Brunei, Guatemala, Marshall Islands, Montserrat, Nauru, Niue, Philippines. However this might be updated following the Global Forum meeting in Cape Town in October 2012. It is very likely that any future decision on who is and who is not to be deemed to have implemented or applied the Global Forum standards will be highly arbitrary and politically biased. More than a distorted, highly political "usual suspects" list cannot be expected of the Global Forum.

Another flaw of the Global Forum's ToR is their extremely ambivalent and lax stance regarding information on trusts. They only require that jurisdictions *"take all reasonable measures to ensure that information is available to their competent authorities that identifies the settlor, trustee and beneficiaries of express trusts"* (point A.1.4. on p. 4-5; my emphasis) The question, of course, is, what do they mean by "reasonable measures"? Footnote 9 gives the following answer: "The Global Forum will re-examine this aspect in light of the experience gained by jurisdictions in the context of the peer reviews..." In other words, the Global Forum has absolutely no idea on how to deal with secrecy when it comes in the guise of trusts and similar legal arrangements.

A related problem has to do with discretionary foundations. The Global Forum's ToR state that jurisdictions should *"identify the founders, members of the foundation council, and beneficiaries (where applicable)"* (point A.1.5 on p. 5). The addition "where applicable" means that jurisdictions providing discretionary foundations (such as



"Ermessensstiftungen" in the case of Liechtenstein) are off the hook. Without any meaningful measures against secrecy in the form of discretionary foundations (and trusts), the proposed action plan is doomed to fail.

The **second set of standards refers to harmful tax practices and uses the criteria put forward on the EU Code of Conduct on Business Taxation**. The reference to the Code of Conduct brings in a number of additional criteria in addition to secrecy/exchange of information. The starting point of the Code of conduct is the existence of measures that allow for a "lower effective level of taxation than those levels which generally apply in the third country". While this approach has also been used in other definitions of tax havens, the way it is worded can be problematic because a country with very low effective taxation levels would not be considered as implementing harmful tax practices. Some tax havens may therefore decide to lower effective taxation rates for companies or certain types of income, for instance, in order to avoid being considered as implementing harmful tax practices. Obviously, this would also have an impact on their income which might or might not be offset by attracting additional tax planning schemes. In any case, the problem of harmful tax competition remains unresolved.

A typical example of such harmful tax measures are Switzerland's special tax regimes for holding, domiciled and mixed companies. Switzerland has long been under pressure by the EU to abolish these special tax regimes. The proposed measures will increase this pressure. The problem, however, is that Switzerland will most likely end the dispute by lowering all corporate taxes to the level of the current special regimes. With a very low generalised (effective) tax rate somewhere in the range of 10-20%, Switzerland will no longer violate the Code of Conduct, but will still attract massive foreign direct investment and encourage aggressive tax planning/profit shifting. In short, the proposed actions against harmful tax measures are just a first step. They won't do much against socially devastating tax competition; nor will they keep multinational companies from shifting their profits to low-tax jurisdictions.

The EU code of Conduct also introduces several additional criteria which are essential to identify tax practices which have been created purely with the idea of attracting or facilitating tax planning. Granting

special tax breaks to non-residents or allowing the registration of companies with no real economic activity are key in international tax planning schemes. However, in virtue of the discussion above this would only be considered harmful if they provide for lower effective taxation level in the country in question (see previous paragraph).

Lack of transparency is redundant given the earlier reference to the OECD Global Forum process. The reference to international rules and principles is a common reference and does not add much to the criteria as these measures are commonly implemented in trade agreements, etc. It is usually implementation and monitoring which pose a greater challenge.

### **Blacklisting**

The recommendation proposes the creation of national blacklists. Although this may seem a bit awkward, particularly given that the recommendation proposes a common set of criteria, it is possibly the result of the different ways in which the Recommendation can be implemented if adopted (we need to find more information about the actual implementation). In any case, it would be difficult to explain the existence of different lists if all countries have to use the same criteria.

Ideally, the EC should have a European Black-List of tax havens. This list should be based on clear-cut criteria that would allow objective identification of those jurisdictions which would be deemed non-compliant. However a list could initially be made based on the Global Forum and EC Code of conduct but with a review clause. Reviews should consider adopting more objective criteria such as the amount of information exchanged with other countries in comparison to the amount of data requests received. This is the only way to ensure coordination; that the measures described below has the maximum impact possible; and prevent EU tax planners from exploiting differences in national lists.

Depending on the assessment after application of the criteria, automatic counter measures should become applicable. The counter measures should be European, not left to the national level only.



On the other hand, national lists could prevent the recommendation resulting in a highly politicised and negotiated process like the OECD Global Forum. At the same time, national lists would allow countries to be more ambitious and incentivise 'positive tax competition' this is politically unlikely.

### **Measures in favour/against third countries**

The national lists would be the basis for the adoption of measures against/in favour of tax havens. As a consequence, most likely measures will be adopted at the Member State level, rather than a common EU approach. The latter would be a much more desirable approach (see above) and should include a common mechanism or assessing third countries' compliance with the common criteria. Of course these would have to differentiate between targeted EU and Non-EU countries as the treaty freedoms and applicable secondary law might allow for certain measures within the EU that don't have to be respected for relations with third countries.

Such countermeasures or sanction regimes should be applied in enhanced cooperation in case an EU-27 approach is not possible.

Measures **against** include:

- Blacklisting
- Renegotiation, suspension or termination of double taxation agreements with listed countries

Measures **in favour of compliant countries**:

- De-listing both from the national list and other EU lists
- Initiating bilateral negotiations for double taxation agreements

Measures **in favour of countries committed to comply**:

- Closer cooperation and assistance, particularly with developing countries, in the areas of tax evasion and aggressive tax planning. This includes the secondment of experts
- Suspension of punitive measures listed above
- Double Taxation Agreements (DTAs)

The Recommendation proposes bilateral Double Taxation Agreements (DTAs) as a possible reward for countries which comply with minimum transparency standards (point 5.3). From a development perspective, this "reward" may backfire. While DTAs restrict developing countries' ability to tax corporate income (royalties, dividends and interest payments) from foreign investors, their effect on foreign direct investment inflows (FDI) is unclear. According to a research article by Eric Neumayer, DTTs are only effective in attracting additional FDI in the group of middle-, not low-income developing countries. It is highly questionable if DTAs should be promoted at all as: double taxation can be prevented through unilateral measures; DTA's reinforce a bilateral rather than multilateral approach to transnational tax issues; DTAs appear to encourage transfer pricing and regulatory arbitrage; DTA's are often particularly risky for developing countries, the complexity of such treaties means that they often lack the expertise to get a fair deal. Tax Information Exchange Agreements (TIEA) would appear preferable to DTAs especially in the case of low-income countries.

The list of measures in favour is quite restricted. Measures in favour could potentially include other issues such as financial assistance; information exchange; training and exchange of experts; legislative measures on thin capitalization, transfer pricing rules, transparency standards on contracts and payments; and parliamentary and civil society oversight

The list of measure against is also restricted, although it would potentially allow the (double) taxation of income, thereby cancelling out the benefits of using tax havens. Other measures could include: restricting procurement of good and services from companies based in tax havens or limiting EIB investments through tax havens. It is also worth highlighting that once more there is no coordination among member states and we could see different measures being adopted in different countries. At the very least payments to such jurisdictions should not be tax deductible as is the case in the Netherlands.

The existence of a waiver/exemption for countries committed to comply could result in a Global Forum style process: where countries do the bare minimum to fall into this category). In addition, the lack of coordination could lead to lack of consistency among Member States when it comes to classifying a given



jurisdiction (listed in one country and considered as committed comply in others).

### **Implementation**

It is **unclear whether all Member States will have to implement the Recommendation and the final form it will adopt** if approved.

### **Comments on the EC Recommendation on aggressive tax planning**

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The starting points are very promising. The two-way approach namely elimination of double non-taxation plus a general anti-abuse rule (although we need more evidence and analysis about how well these work and in what circumstances) forms a potentially strong and effective approach. However, there are various weaknesses, complexities and implementation problems.

The first part, elimination of double non-taxation, only covers situations where income is not at all "subject to tax" (point 4.2). This is too narrow. Income might also be subject to a near zero tax rate, or due to an artificial tax base definition only a very small part of the income may be subject to tax (see the Energias de Portugal example in the Annex), or the income itself might initially be subject to normal tax but then an artificial offsetting tax-deduction is allowed. This problem is exacerbated by opaque tax exemptions in some countries. Member states should be required and third countries encouraged to make all tax exemptions and rulings public, where this is not the case companies should have to show proof of the taxes they have actually paid in third countries. Situations where there is extremely low taxation are essentially similar to non-taxation. Perhaps the wording could be changed into "subject to tax at an effective tax rate of at least 10%" or some "at an acceptable effective tax rate" or something of the like, taking into account deductions for expenses that were not actually incurred.

The wording would conflict with tax sparing clauses in tax treaties and national legislation, often intended for developing countries. These clauses treat foreign income as if it were taxed at the normal rate of the partner country, even if the partner country provides a tax benefit, e.g. a corporate income tax holiday or exemption from withholding tax. It seems preferable

chose a wording that allows tax sparing (that is, non-taxation or with an artificial deduction) by the country where the income is received, on the strict condition that the source country is not a tax haven and chooses itself not to tax the income.

In the second part, the identification of "artificial arrangements" with an "essential purpose" ... in 5.2 will be difficult to implement. Not just because these terms are difficult to define, but also because it will be difficult for a country where tax is avoided (eg. the source country of certain income) to determine whether a structure elsewhere (eg. in one or more intermediate countries) is artificial and does not serve a real business purpose. This approach might only work if EU member states that identify an artificial arrangement with the essential purpose to avoid tax in ANOTHER country (another EU member state or third country, let's keep developing countries in mind) will spontaneously exchange information with the tax authorities in that country. A recommendation to that effect should be added.

The EU Action Plan could have been more ambitious setting the criteria for determining whether tax arrangements are artificial. For instance, France has inverted the burden of the proof for all the subsidiaries located in low tax jurisdictions (defined a jurisdictions with less than 50% of the amount of corporate tax due in France). It is no longer the tax administration, but companies who need to show evidence of the lack of economic substance. If the company fails to provide information of the reality of its activities, the subsidiary will be taxed in France.

### **Annex**

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Energias de Portugal SA has a subsidiary in the Netherlands (EDP Finance BV) that issues publicly traded bonds and lends the proceeds onwards to related entities abroad. In 2007, the subsidiary obtained an APA that specifies its minimum taxable income as an arms-length return on equity plus a spread of 0.03% on on-lent funds, minus operational costs. At the start of 2010, the subsidiary had total equity of EUR 23 million while it had on-lent over EUR 10 billion. Due to the tax ruling, the subsidiary's tax charge for 2010 was less than EUR 1 million even though it earned net interest income, after



operational costs and expenses, of EUR 63 million. This illustrates that unilateral APAs specifying an alternative tax base may result in almost complete double non-taxation of intra-group payments, because the payments may be tax deductible in one member state but largely excluded from the tax base in another member state due to such an APA. The annual accounts of EDP can be found on: <http://www.edp.pt/en/Investidores/publicacoes/relatoriocontas/Pages/RelatorioeContas.aspx>